



**Models of Development in
the Twentieth Century |**

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“शिक्षा मानव को बन्धनों से मुक्त करती है और आज के युग में तो यह लोकतंत्र की भावना का आधार भी है। जन्म तथा अन्य कारणों से उत्पन्न जाति एवं वर्गगत विषमताओं को दूर करते हुए मनुष्य को इन सबसे ऊपर उठाती है।”

— इन्दिरा गांधी

“Education is a liberating force, and in our age it is also a democratising force, cutting across the barriers of caste and class, smoothing out inequalities imposed by birth and other circumstances.”

— Indira Gandhi



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BLOCK 2 MODELS OF DEVELOPMENT IN THE TWENTIETH CENTURY I

This block discusses about models of economic development in the twentieth century, comparative analysis of experiences of various countries and contemporary issues related to capitalistic and socialistic approaches to development.

Unit 5 This unit provides discussion about the capitalistic approach to development. It explains the meaning of capitalism and different stages of its growth in the history. It also explains the characteristic features of capitalism and capitalistic market economy. Further, discussions are made on capitalistic mode of production and its outlook for the future.

Unit 6 Attempt is made in this unit to explain the development experiences of United States, Japan and Western Europe.

Unit 7 This unit explains the socialistic approach to economic development. In the beginning attempt is made explain the history of socialism and socialist revolution. Further it explains the socialist command economy, the socialistic mode of production, and how socialism copes with issues of scarcity.

Unit 8 This unit attempts to discuss the development experience of Soviet Union, People's Republic of China and Eastern Europe. Socialistic features of their economies are highlighted.

Unit 9 This unit provides explanation about the meaning of Market Socialism, and theoretical basis of Market Socialism, problems of Market Socialism, and experience of Scandinavian and Nordic Countries.

UNIT 5 CAPITALISTIC APPROACH

Structure

- 5.0 Objectives
- 5.1 Introduction
- 5.2 Meaning of Capitalism
- 5.3 History of Capitalism
 - 5.3.1 Merchant Capitalism and Mercantilism
 - 5.3.2 Beginning of Modern Capitalism
 - 5.3.3 The Physiocrats
 - 5.3.4 The Doctrine of Adam Smith
 - 5.3.5 Industrial Capitalism and Laissez-faire
 - 5.3.6 Finance Capitalism and Monopoly Capitalism
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 - 5.3.8 Globalisation
- 5.4 The Capitalist Market Economy
- 5.5 Characteristic Features of Capitalism
- 5.6 Outlook for the Future
- 5.7 Capitalistic Mode of Production
 - 5.7.1 Types of Commodity Production
 - 5.7.2 How does Capitalism Copes with Scarcity?
- 5.8 Let Us Sum Up
- 5.9 Key Words
- 5.10 Some Useful Books
- 5.11 Answer or Hints to Check Your Progress
- 5.12 Exercises

5.0 OBJECTIVES

After going through this unit, you will be able to:

- explain the meaning, characteristic features and history of Capitalism;
- describe the functioning of the capitalist market economy;
- describe more about the Capitalistic Mode of Production; and
- assess the future outlook of the Capitalism.

5.1 INTRODUCTION

Capitalism evolved and is playing an important role since the industrial revolution. Capitalists have strong command. One needs to first understand the meaning of capitalism and its historical revolution. This becomes more relevant in the context of globalisation, where market is open and competitive. The basic idea of capitalistic approach for development is that market rules the economy and hence, investment, production and such other activities of the economy have to be designed accordingly.

To understand the capitalistic approach to development, we need to understand its meaning and historical evolution and therefore the experiences of different countries that adopted this approach, need to be analysed.

5.2 MEANING OF CAPITALISM

Capitalism is a word that has had many meanings, and is still in dispute. It can be interpreted socially, economically or politically; it can be described in engineering terms as well as in human terms.

Capitalism is can be simply defined as an economic system, marked by open competition in a free market, in which the means of production and distribution are privately, or more appropriately corporately owned and development is proportionate to increasing accumulation and reinvestment of profits. However, capitalism tends to incorporate a certain "way of thinking", driven by greed, the search for ever-increasing profits, worldwide expansion, and internal development.

Capitalism is also defined as an economic and social system in which the nation's farms, factories, and mines are owned predominantly by private individuals, partners, and stockholders. Although social ownership may be present, and it may be substantial, it is an exception rather than a rule. The market system is the basic coordinating mechanism under capitalism, but each country modifies the forces of supply and demand with its own assortment of traditional behaviours, industrial policies, social welfare programmes, cultural, and other instruments of social and governmental control. Thus, there are clear distinctions among the economic systems in the United States, Germany, Japan, and the scores of other capitalist nations.

Capitalism is mainly a feature of the North Atlantic. It probably started in Italy, spread into Holland, then England, and across the Atlantic to the North American littoral. After that it spread until its tentacles embraced parts of every continent. Capitalism therefore, though based on the North Atlantic, was the first world wide civilisation.

Capitalism evolved through a number of stages, reaching its zenith in the 19th century. From Europe, and especially from England, capitalism spread throughout the world, largely unchallenged as the dominant economic and social system until World War I ushered in modern communism as a vigorous and hostile competing system.

5.3 HISTORY OF CAPITALISM

Though scholars have found capitalism, or elements thereof, in very early times, some philosophers and most neoclassical economists consider capitalism not a time-bound practice or a historical era at all, but the recognition of some timeless elements of human society like private property and market price.

The history of capitalism dates back to early forms of merchant capitalism practiced in the Middle East and Western Europe during the Middle Ages, though many economic historians consider the Netherlands as the first thoroughly capitalistic country. Since pre-Roman times goods have been bought and sold on markets throughout Europe, and local trading networks have enabled goods to make their way onto European markets from places as far away as China and India. Much of the expansion of the Roman Empire was at least partially driven by the desire to obtain control of the sources of goods being traded with the Romans (such as tin and cement), and thus, obtain these goods more cheaply by cutting out the middlemen. During the Mauryan Empire in India, there were a number of organisational entities similar to corporations. These were mostly privately owned commercial

entities concerned with raising capital. Some economists like Peter Temin consider the Roman Empire as market economy, similar in degree of capitalistic practices to 17th century Netherlands and 18th century England.

5.3.1 Merchant Capitalism and Mercantilism

The earliest stages of merchant capitalism can be traced back to the medieval Islamic world during the 9th-12th centuries, where a vigorous monetary market economy was created on the basis of the expanding levels of circulation of a stable high-value currency (the Dinar) and the integration of monetary areas that were previously independent. Innovative new business techniques and forms of business organisation were introduced by economists, merchants and traders during this time. Such innovations included trading companies, bills of exchange, contracts, long-distance trade, big business, the first forms of partnership (such as limited partnerships, and the concepts of credit, profit, capital and capital accumulation). Many of these early capitalist ideas were further advanced in medieval Europe from the 13th century onwards.

The most distinctive feature of mercantilism was the state's preoccupation with accumulating national wealth in the form of gold and silver. Because as most nations did not have a natural resources of such precious metals, the best way to acquire them was through trade. This meant striving for a favourable trade balance, that is, a surplus of exports over imports. Foreign states would then have to pay for imports in gold or silver. Mercantilist states also favoured maintaining low wages, believing that this would discourage imports, contribute to the export surplus, and thus swell the influx of gold.

More sophisticated proponents of the mercantilist doctrine understood that the real wealth of a nation was not its hoard of precious metals, but its ability to produce. They correctly saw that the influx of gold and silver from a favourable trade balance would serve as a stimulus to economic activity generally, thus, enabling the state to levy more taxes and gain more revenue. Only a few states that practiced mercantilism, however, understood this principle.

Modern capitalism did not arise until the early modern period, between the 16th and 18th centuries, when merchant capitalism and mercantilism were established. This period was associated with geographic discoveries by merchant overseas traders, especially from England, Portugal, Spain; the European colonisation of the Americas; and the rapid growth in overseas trade.

5.3.2 Beginning of Modern Capitalism

Two developments paved the way for the emergence of modern capitalism; both took place in the latter half of the 18th century. The first was the appearance of the physiocrats in France after 1750; and the second was the devastating impact that the ideas of Adam Smith had on the principles and practice of mercantilism.

5.3.3 The Physiocrats

Physiocracy is the term applied to a school of economic thought that suggested the existence of a natural order in economics, one that does not require direction from the state for people to be prosperous. The leader of the Physiocrats, the economist François Quesnay, set forth the basic principles in his *Tableau Économique* (1758), in which he traced the flow of money and goods through the economy. Simply put, this flow was seen to be both circular and self-sustaining. More important, however, was that it rested on the division of society into three main classes: (1) The productive class was made up of those engaged in agriculture, fishing, and mining, representing one-half of the population. (2) The proprietary class consisted of landed proprietors and those supported by them, which amounted to one-quarter of the population. (3) The artisan, or sterile, class, made up the rest of the population.

5.3.4 The Doctrine of Adam Smith

The ideas of Adam Smith represented more than just the first systematic treatise on economics; they were a frontal attack on the doctrines of mercantilism. Like the Physiocrats, Smith tried to show the existence of a “natural” economic order, one that would function most efficiently if the state played a highly limited role. Unlike the Physiocrats, however, Smith did not believe that industry was unproductive or that only the agricultural sector was capable of producing a surplus above the subsistence needs of society. Rather, Smith saw in the division of labour and the extension of markets almost limitless possibilities for society to expand its wealth through manufacture and trade.

Thus, both the Physiocrats and Smith contributed to the belief that the economic powers of governments should be limited and that there existed a natural order of liberty applicable to the economy. It was Smith, however, far more than the Physiocrats, who opened the way for industrialisation and the emergence of modern capitalism in the 19th century.

5.3.5 Industrial Capitalism and Laissez-Faire

Mercantilism declined in Great Britain in the mid-18th century, when a new group of economic theorists, led by Adam Smith, challenged fundamental mercantilist doctrines as the belief that the amount of the world’s wealth remained constant and that a state could only increase its wealth at the expense of another state. However, in more undeveloped economies, such as Prussia and Russia and, with their much younger manufacturing bases, mercantilism continued to find favour after other states had turned to newer doctrines. The mid-18th century gave rise to industrial capitalism, made possible by the accumulation of vast amounts of capital under the merchant phase of capitalism and its investment in machinery.

The fundamental characteristic of the industrialisation process was the introduction of mechanical power (originally steam) to replace human and animal power in the production of goods and services. As the mechanisation of production gained momentum in England and gradually spread to other parts of the world, several fundamental changes occurred. Production became more specialised and concentrated in larger units, called factories.

The artisans and small shops of the 18th century did not disappear, but they were relegated to the periphery of economic activity in the leading nations, especially in England, the U.S., and Germany. The modern working class began to emerge; workers no longer owned their tools, they had little property, and generally they had to exchange their labour for a money wage. The application of mechanical power to production brought with it a great increase in worker efficiency, which made goods abundant and cheap. Consequently, the real standard of living rose throughout much of the world during the 19th century.

The decline of mercantilism was also associated with the rise of industrial capitalism. Mid- to late-nineteenth-century Britain is widely regarded as the classic case of laissez-faire capitalism. Laissez-faire gained favour over mercantilism in Britain in the 1840s with the repeal of the Corn Laws and the Navigation Acts. In line with the teachings of the classical political economists, led by Adam Smith and David Ricardo, Britain embraced liberalism, encouraging competition and the development of a market economy.

5.3.6 Finance Capitalism and Monopoly Capitalism

In the late 19th century, the control and direction of large areas of industry came into the hands of financiers. This period has been defined as “finance capitalism”, characterised by the subordination of the processes of production to the

accumulation of money profits in a financial system. Major features of capitalism in this period included the establishment of huge industrial cartels or monopolies; the ownership and management of industry by financiers divorced from the production process; and the development of a complex system of banking, and equity market, and corporate holdings of capital through stock ownership. Increasingly, large industries and land became the subject of profit and loss by financial speculators.

Late 19th and early 20th century capitalism has also been described as an era of "Monopoly capitalism" marked by a movement away from laissez-faire capitalism and competitive markets to concentration of capital into large monopolistic or oligopolistic holdings by banks and financiers, and characterised by the growth of large corporations and a division of labour separating shareholders, owners, and managers.

By the last quarter of the 19th century, the emergence of large industrial trusts had provoked legislation in the U.S. to reduce the monopolistic tendencies of the period. Gradually, the U.S. federal government played a larger role in passing antitrust laws and regulation of industrial standards for key industries of special public concern.

By the end of the 19th century, economic depressions and boom and bust business cycles had become a recurring problem. In particular, the Long Depression of the 1870s and 1880s and the Great Depression of the 1930s affected almost the entire capitalist world, and generated discussion about capitalism's long-term survival prospects.

5.3.7 Capitalism Following the Great Depression

The economic recovery of the world's leading capitalist economies in the period following the end of the Great Depression and the Second World War a period of unusually rapid growth by historical standards eased discussion of capitalism's eventual decline or demise.

In the period following the global depression of the 1930s, the state played an increasingly prominent role in the capitalistic system throughout much of the world. In 1929, for example, total U.S. government expenditures (federal, state, and local) amounted to less than one-tenth of GNP; from the 1970s they amounted to around one-third. During the postwar boom, a broad array of new analytical tools in the social sciences was developed to explain the social and economic trends of the period, including the concepts of post-industrial society and welfare states.

5.3.8 Globalisation

For most of the 20th century capitalism has been buffeted by wars, revolution, and depression. World War I brought revolution and a Marxist-based communism to Russia. The war also spawned the Nazi system in Germany, a malevolent mixture of capitalism and state socialism, brought together in a regime whose violence and expansionism eventually pushed the world into another major conflict. In the aftermath of World War II, Communist economic systems took hold in China and Eastern Europe. However, as the cold war came to an end in the 1980s and the former Soviet-bloc nations turned to free enterprise (though with mixed success at first), China was the only major power to retain a Marxist regime. Many of the developing nations, strongly influenced by Marxist ideas in the early postcolonial period, turned to a modified form of capitalism in their search for answers to economic problems.

In the industrial democracies of Western Europe and North America, the sharpest

challenge to capitalism came in the 1930s. The Great Depression was by far the most severe economic upheaval endured by modern capitalism since its beginnings in the 18th century. Contrary to the logic of Marx's prophecy, however, Western nations failed to collapse into revolution. Rather, in meeting the challenge of the Depression, these capitalist systems demonstrated remarkable abilities for survival and adaptability to change. Democratic governments began to intervene in the economy to correct the worst abuses inherent in capitalism.

The most important intellectual event in the development of contemporary capitalism was the publication by the British economist John Maynard Keynes of *General Theory of Employment, Interest and Money* (1936). Like Adam Smith's ideas from an earlier era, Keynes's thought profoundly affected the way in which capitalism worked in Western democracies.

Keynes demonstrated that it is possible for a modern government to use its powers to spend money, vary taxes, and control the money supply in ways that can dampen down, if not eliminate, the age-old curse of capitalism, cycles of "boom and bust".

Although overseas trade has been associated with the development of capitalism for over five hundred years, some thinkers argue that a number of trends associated with globalisation have acted to increase the mobility of people and capital since the last quarter of the 20th century, combining to circumscribe the room to maneuver of states in choosing non-capitalist models of development. Today, these trends have bolstered the argument that capitalism should now be viewed as a truly world system. However, some thinkers argue that globalisation, even in its quantitative degree, is no greater now than during earlier periods of capitalist trade.

After the abandonment of the Bretton Woods system and the strict state control of foreign exchange rates, the total value of transactions in foreign exchange was estimated to be at least twenty times greater than that of all foreign movements of goods and services. The internationalisation of finance, which some see as beyond the reach of state control, combined with the growing ease with which large corporations have been able to relocate their operations to low-wage states, has posed the question of the 'eclipse' of state sovereignty, arising from the growing 'globalisation' of capital.

Check Your Progress 1

1) What do you mean by Capitalism?

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2) What are the different stages of historical evaluation of the capitalism?

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5.4 THE CAPITALIST MARKET ECONOMY

The capitalist system is one characterised by the private ownership of the means of production, individual decision making, and the use of the market mechanism to carry out the decisions of individual participants and facilitate the flow of goods and services. The capitalist economy is characterised by a voluntary exchange of goods and services in markets. This exchange is clear from the interaction of households and firms in the exchange of finished products and services (factors of production).

In a capitalist economy, households and firms are the basic production units. Each individual household is the owner of productive factors. These factors include the household's own labour and may also include land, capital, and raw materials. Each household sells the services of its factors to the basic production units, the firm. The private firms organised by individuals; these private firms combine these productive factors to produce goods. The difference between revenues and costs constitute profits, which then form the income of the firm's organisers. The income earned from the sale of household's productive factors enables it to purchase the finished products of the firms. Those households in possession of larger holdings of productive resources will earn greater incomes. This will allow them to purchase a larger portion of the output of firms.

In a capitalist economy, each market participant, whether buyer or seller is trying to buy cheap and sell dear. Each is interested in maximising his own welfare. The consumer attempts to select that bundle of goods and services which will maximise his satisfaction with the least expenditure on his part. The firm attempts to select that combination of inputs that will produce a given quantity of output at the least possible cost. Both the consumer and firm are weighing benefits and costs, attempting to pick the optimum combination.

Each economic unit is guided by price in his selection of inputs and final outputs. Commodity prices are formed as a result of the aggregation of the demand and supply offers of market participants. If a product is in short supply relative to consumer demand, its price will rise. If one type of labour service is in excess supply relative to firms' demands, its price will fall. In a market system prices tend to reflect the relative availability of resources and the strength of consumer preferences. Prices provide the consumer and the firm, with information with respect to the cost of alternatives. A change in consumer preferences or the availability of factors of production will initially be reflected in their prices. The price change will signal to the buyer the fact that the cost of alternatives has changed and this will ultimately result in a change in the consumption and production patterns of the society.

The pure form of capitalism is the perfectly competitive market economy. Under the conditions of perfect competition, no individual unit is large enough to influence market price. Resources are homogeneous and perfectly mobile. Thus, firms do not discriminate among resource sellers, and resource seller always seeks out the highest bid. Under the conditions of perfect competition, each market participant is checked in his search for income and profits by the actions of his rivals. No firm can arbitrarily raise prices in an attempt to secure higher profits, for his competitors would undercut him and drive him out of business.

If the competitive market economy is functioning properly, government has no direct productive economic function. Intervention by government is regarded as having an unnecessarily disturbing influence on producers or consumers or both. The role of government is therefore limited to the establishment and enforcement of the rules of exchange. The government facilitates the exchange process by the protection of private property and the enforcement of contracts.

There are no economies in existence today, nor have any existed ever in the past, that meet the rigid requirements of perfect competition. The existence of monopoly power on the part of big business and organised labour, the immobility of resources, particularly labour, due to lack of knowledge and social and psychological barriers, and the 'stickiness' of prices all contribute to substantial deviations of real behaviour from ideal behaviour. There are economies, the United States and West Germany for example, which contain many of the characteristics of competitive market system and are singled out as examples of capitalism. We shall study these examples later in the text to analyse the complex interweaving of market and non market economic institutions.

To sum up, the key feature of capitalism, whether of a perfect or imperfect variety, is the decentralisation of decision making. The choice of what to produce and how to produce it are made by thousands of individual consumers and firms according to their own self interest. Prices, determined by the impersonal forces of supply and demand, provide the necessary information to the market which permits participants to choose among alternatives.

5.5 CHARACTERISTIC FEATURES OF CAPITALISM

As already said capitalism is a system of economic organisation in which individual persons, singly or in groups, privately owns the factors of production and possesses the right to use and dispose those economic resources generally in whatever matter they choose.

Throughout its history, but especially during its ascendancy in the 19th century, capitalism has had certain key characteristics. First, basic production facilities – land and capital – are privately owned. Capital in this sense means the buildings, machines, and other equipment used to produce goods and services that are ultimately consumed. Second, economic activity is organised and coordinated through the interaction of buyers and sellers (or producers) in markets. Third, owners of land and capital as well as the workers they employ are free to pursue their own self-interests in seeking maximum gain from the use of their resources and labour in production.

Consumers are free to spend their incomes in ways that will yield them greatest satisfaction. This principle, called consumer sovereignty, reflects the idea that under capitalism producers will be forced by competition to use their resources to best satisfy the wants of consumers. Self-interest and the pursuit of gain lead them to do this. Fourth, under this system a minimum of government supervision is required; if competition is present, economic activity will be self-regulating. Government will be necessary only to protect society from foreign attack, uphold the rights of private property, and guarantee contracts. This 19th-century view of government's role in capitalism has been significantly modified by ideas and events of the 20th century.

Following are some of the **characteristic features of capitalism**:

- Freedom of enterprise - In capitalism economic activities will be conducted by managers of firms instead of entrepreneurs.
- Competition - all factors of production be privately owned and controlled. Some of the benefits of this system are that it (a) allows prices to reflect supply and demand, (b) will show prices and costs to be efficient, (c) encourages innovation, invention, flexibility, and decrease in the long run cost, (d) encourages equitable distribution of income, (e) provides a variety of goods and services.

- Unlimited use of Wants - right of individuals to employ his or her talents and energies in the matter he or she deems best to promote personal interest.
- Non-economic institutions have significant bearing in capitalism in its development.
- There should be some economic institutions in capitalism like private property, freedom of enterprise and choice, competitive markets, limited government, individualism, Protestant work ethic etc.
- Private Property - right of individual to control property and the right to enjoy the economic rewards that result and government protects owner's claims.
- Freedom of enterprise - gives individual owners the right to select economic activity in which their economic resources will be employed. In capitalism, it is entrepreneurship, owning capital, and generally, exercising self interest (maximisation of self-interest and satisfaction-producing where $MR=MC$).
- Rationing - it allocates goods and services to those willing to pay prevailing price and willingness depends of purchasing power. Rationing takes place also among producers who are able to make more efficient use of resources.
- Motivating - both in factor and product market, price increases are created by increase in demand and price decreases are created by decrease in demand and these shifts in supply and demand result in equilibrium.
- Price may affect consumer choices - price will tell us the way in which resources will be employed.
- Government with regulatory matters - Government should have checks and balances and it must preserve social values and use regulatory measures. Government must exist to stop existing institutions from destroying themselves.

Check Your Progress 2

1) How does a capitalistic market economy function?

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2) What are the characteristics of Capitalism?

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5.6 OUTLOOK FOR THE FUTURE

For 25 years after World War II the mixture of Keynesian ideas with traditional forms of capitalism proved highly successful. Western capitalist countries, including the defeated nations of World War II, enjoyed nearly uninterrupted growth, low rates of inflation, and rising living standards. Beginning in the late 1960s, however, inflation erupted nearly everywhere, and unemployment rose.

In most capitalist countries the Keynesian formulae apparently no longer worked. Critical shortages and rising costs of energy, especially petroleum, played a major role in this change. New demands imposed on the economic system included ending environmental pollution, extending equal opportunities and rewards to women and minorities, and coping with the social costs of unsafe products and working conditions. At the same time, social-welfare spending by governments continued to grow. In the U.S., these expenditures (along with those for defense) account for the overwhelming proportion of all federal spending.

The current situation needs to be seen in the perspective of the long history of capitalism, particularly its extraordinary versatility and flexibility. The events of this century, especially since the Great Depression, show that modified "mixed" or "welfare" capitalism has succeeded in building a floor under the economy. It has so far been able to prevent economic downturns from gaining enough momentum to bring about a collapse of the magnitude of the 1930s. This is no small accomplishment, and it has been achieved without the surrender of personal liberty or political democracy.

The inflation of the 1970s came to an end in the early 1980s, mainly because of two developments. First, restrictive monetary and fiscal policies led in 1981-82 to a deep recession, both in the U.S. and in Western Europe. As unemployment rose, inflation slowed. Second, energy prices dropped as worldwide oil consumption moderated. In the mid-1980s most Western economies recovered from the recession, but then the stock market crashes of 1987 introduced a new period of financial instability. Economic growth slowed, and many nations in particular the U.S., where the national, corporate, and personal debt had reached record levels dropped into recession, with rising unemployment, in the early 1990s.

5.7 CAPITALISTIC MODE OF PRODUCTION

The capitalist mode of production was analysed by Marx in his *Capital* and the ideas he expounded were developed further by Lenin in his book *Imperialism, the Highest Stage of Capitalism*.

Marx's analysis of capitalism begins with commodity production. Commodity production emerged with the disintegration of the primitive communal system. It existed in all pre-capitalist systems. At the time, however, subsistence economies predominated.

In a commodity economy, products are made by separate producers for exchange. This type of economy is based on the social division of labour, where each producer specialises in some one product. The producers are isolated from one another due to the private ownership of the means of production and products of labour. As a result, market exchange becomes necessary. The exchange of commodities becomes the sole kind of economic relationship linking the separate producers.

5.7.1 Types of Commodity Production

There are two types of commodity production, simple and capitalist, in pre-socialist societies. Under simple commodity production small producers own the means of production and are workers at the same time. In this economy there is no exploitation. As a private property owner, the small producer gravitates toward the bourgeoisie, while as a worker; he sides with the working class, supporting its struggle against the bourgeoisie. This is the economic foundation of the alliance between the workers and peasants.

Capitalist commodity production is conducted by the capitalists, exploiting wage labour. Here the means of production are separated from the producers. The purpose of such production is to secure profit. Yet, distinct as they are, the simple commodity economy and the capitalist economy are basically of the same type, as both rest on private ownership of the means of production. This fact makes possible the transformation of a simple commodity into a capitalist economy.

Simple commodity production was historically the starting point of capitalism. Under capitalism, the production of commodities becomes universal. All products became commodities, being produced for exchange. Labour power, too, becomes a commodity. The wealth of capitalist society consists of a huge mass of commodities, the individual commodity being the elementary form of this wealth.

5.7.2 How does Capitalism Cope with Scarcity?

In a capitalistic system households own the factors of production and are free to use these factors and the income they receive from the sale of their services in any way they choose. These choices are governed by their preferences. The preferences of households are all powerful in a capitalist economy.

Factors of production flow from households through factor markets to firms and goods flow through goods markets from firms to households. What is produced, how it is produced and to whom it is produced is determined by the preferences of the households, the resources that they own and the technologies available to the firms.

No one plans a capitalist economy. Each individual household and firm involved in this process allocates the resources that it controls in the way that seems best for it. Each firm tries to maximise its profit and each household tries to maximise its utility. These plans are coordinated in the markets for health care equipment, computers, engineers, computer programmers, insurance, hospital services, nurses, doctors and hundred of other markets for items that range from anesthetic chemicals to paper gowns, through the invisible hand of the price mechanism.

Under capitalism, the preferences of individual households dictate the choices that are made. Households own all the factors of production and sell the services of those factors in factor markets. Households decide which goods and services to consume and buy them in commodity markets. Firms decide which goods and services to produce and which factors of production to employ, selling their output in goods markets and buying their inputs in factors markets.

The markets find the prices that bring the quantities demanded and quantities supplied into equality for each factor of production and each good or service. Capitalism economises on information because households and firms need to know only the prices of various goods and factors that they buy and sell.

When a surgeon performs an operation, an incredible amount of information is used. Yet no one person or firm possesses all this information. It is not centralised in one place the capitalist economic system economises on information. Each household or firm needs to know little about the other households and firms with which it does business. The reason is that prices convey most of the information it needs. By comparing the prices of factors of production, each household chooses the quantity of each factor to supply. And by comparing the prices of goods and services, it chooses the quantity of each to buy. Similarly, by comparing the prices of factors of production, each firm chooses the quantity of each factor to use, and by comparing the prices of goods and services, it chooses the quantity of each to supply.

Check Your Progress 3

1) How do you look into the future of capitalism?

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2) How capitalistic mode of production takes place?

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5.8 LET US SUM UP

In this unit we have discussed the meaning and characteristic features of capitalism. We have also seen that the capitalism has grown in different stages in its history. These stages we have seen in terms of Merchant Capitalism and Mercantilism, the Physiocrats, the Doctrine of Adam Smith, the beginning of Modern Capitalism, Industrial capitalism and laissez-faire, Finance capitalism and monopoly capitalism, Globalisation and Capitalism following the Great Depression. We have also discussed the capitalist market economy, and the capitalistic mode of production and the outlook for the future of capitalism.

5.9 KEY WORDS

Capitalism

: Capitalism defined as an economic system, marked by open competition in a free market, in which the means of production and distribution are privately (or corporately) owned and development is proportionate to increasing accumulation and reinvestment of profits.

Merchant Capitalism

: Merchant capitalism existed during the 9th-12th centuries, where a vigorous monetary market economy was created on the basis of the expanding levels of circulation of a stable high-value currency (the Dinar) and the integration of monetary areas that were previously independent. Innovative new business techniques and forms of business organisation were introduced by economists, merchants and traders during this time. Such innovations included trading companies, bills of exchange, contracts, long-distance trade, big business, and the first forms of partnership.

- Mercantilism** : The most distinctive feature of mercantilism was the state's preoccupation with accumulating national wealth in the form of gold and silver. Because most nations did not have a natural abundance of such precious metals, the best way to acquire them was through trade.
- Industrial Capitalism** : Industrialisation process introduced mechanical power (originally steam) to replace human and animal power in the production of goods and services, and it arose to competition for factors of production and division of labour.
- Market Economy** : The capitalist economy is characterised by a voluntary exchange of goods and services in markets. Markets may be competitive in nature or monopoly.
- Capitalistic Mode of Production:** Capitalist commodity production is conducted by the capitalists, exploiting wage labour. Here the means of production are separated from the producers. The purpose of such production is to secure profit.
- Globalisation** : Opening up of economy world wide.

5.10 SOME USEFUL BOOKS

- 1) Backhouse R (1985): "*A History of Modern Economic Analysis*" Basil Black Well, Oxford University press, New York.
- 2) Blaug M (1978): *Economic theory in Retrospect*, 3rd Edition, University Press, Cambridge.
- 3) John Vaizey (1980): "*Capitalism and Socialism a History of Industrial Growth*", Faken ham Press Limited.
- 4) Paul M Sweezy (1970): "*The Theory of Capitalist Development*", The Modern Reader Paper Back Press.

5.11 ANSWER OR HINTS TO CHECK YOUR PROGRESS

Check Your Progress 1

- 1) Capitalism can be simply defined as an economic system, marked by open competition in a free market, in which the means of production and distribution are privately or corporately owned and development is proportionate to increasing accumulation and reinvestment of profits.
- 2) Different stages of capitalism may be explained as follows:
 - i) Merchant capitalism and mercantilism
 - ii) The Physiocrats
 - iii) The Doctrine of Adam Smith

- v) Beginning of modern capitalism
- v) Industrial capitalism and laissez-faire
- vi) Globalisation

Check Your Progress 2

- 1) In a capitalist economy, households and firms are the basic production units. Each individual household is the owner of productive factors. These factors include the household's own labour, land, capital, and raw materials. Each household sells the services of its factors to the basic production unit, the firm. The private firms, organised by individuals, combine these productive factors to produce goods.
- 2) Characteristic features of capitalism are freedom of enterprise, competition, unlimited use of wants, private property and limited government interference.

Check Your Progress 3

- 1) The current situation needs to be seen in the perspective of the long history of capitalism, particularly its extraordinary versatility and flexibility. The events of this century, especially since the great depression, show that modified "mixed" or "welfare" capitalism has succeeded in building a floor under the economy. Further, the liberalisation, privatisation and globalisations, trend show capitalism would grow further in future.
- 2) Capitalist commodity production is conducted by the capitalists, exploiting wage labours. Here, the means of production are separated from the producers. The purpose of such production is to secure profit.

5.12 EXERCISE

- 1) Explain capitalistic approach to economic development. What are the characteristic features of capitalism?
- 2) Explain the historical stages of growth of capitalism.

UNIT 6 EXPERIENCE OF UNITED STATES, JAPAN AND WESTERN EUROPE

Structure

- 6.0 Objectives
- 6.1 Capitalistic Approach: Experience of USA
 - 6.1.1 Introduction
 - 6.1.2 Economic History of the United States
 - 6.1.3 Government Intervention: Regulation and Control
 - 6.1.4 Basic Ingredients of the U.S. Economy
 - 6.1.5 Capitalistic Economic Features of United States of America
- 6.2 Capitalistic Approach: Experience of Japan
 - 6.2.1 Brief History of Japanese Economy
 - 6.2.2 Capitalistic Features of Japanese Economy
 - 6.2.3 Protection of Corporations
 - 6.2.4 Developmentalism
 - 6.2.5 Organisation Oriented System
- 6.3 Capitalistic Approach: Experience of Western Europe
- 6.4 Let Us Sum Up
- 6.5 Key Words
- 6.6 Some Useful Books
- 6.7 Answer or Hints to Check Your Progress
- 6.8 Exercises

6.0 OBJECTIVES

After going through this unit, you will be able to:

- analyse the development experience of U S A, Japan and Western Europe in general.

6.1 CAPITALISTIC APPROACH: EXPERIENCE OF USA

6.1.1 Introduction

In every economic system, entrepreneurs and managers bring together natural resources, labour, and technology to produce and distribute goods and services. But the way these different elements are organised and used also reflects a nation's political ideals and its culture.

The United States is the largest national economy in the world, with its capitalistic approaches to economic development. Its gross domestic product (GDP) was estimated as \$13.8 trillion in 2007. The U.S. economy maintains a high level of output per person (GDP per capita, \$46,000 in 2007), ranked at around number ten in the world. The U.S. economy has maintained a stable overall GDP growth rate, a low unemployment rate, and high levels of research and capital investment

funded by both national and, because of decreasing saving rates, increasingly by foreign investors.

Major economic concerns in the U.S. include national debt, external debt, and entitlement liabilities for retiring baby boomers that have already begun withdrawing from their Social Security accounts, corporate debt, mortgage debt, a low savings rate, falling house prices, and a large current account deficit. As of June 2008, the gross U.S. external debt was over \$13 trillion, the highest external debt of all countries in the world. The 2007 estimate of the United States public debt was 65 per cent of GDP. As of October 1, 2008, the total U.S. federal debt exceeded \$10 trillion, about \$31,700 per capita. Inclusive of unfunded Medicaid, Social Security, Medicare and similar promised obligations, the government liabilities rise to a total of \$59.1 trillion, or \$516,348 per household.

6.1.2 Economic History of the United States

The economic history of the United States has its roots in European settlements in the 16th, 17th, and 18th centuries. The American colonies progressed from marginally successful colonial economies to a small, independent farming economy, which in 1776 became the United States of America. In 230 years the United States grew to a huge, integrated, industrialised economy that makes up over a quarter of the world economy. The main causes were a large unified market, a supportive political-legal system, vast areas of highly productive farmlands, vast natural resources (especially timber, coal and oil), and an entrepreneurial spirit and commitment to investing in material and human capital. The economy has maintained high wages, attracting immigrants by the millions from all over the world.

After the Great Depression:

For many years following the Great Depression of the 1930s, when the danger of recession appeared most serious, government sought to strengthen the economy by spending heavily itself or cutting taxes so that consumers would spend more, and by fostering rapid growth in the money supply, which also encouraged more spending. In the 1970s, economic woes brought on by the costs of the Vietnam conflict, major price increases, particularly for energy, created a strong fear of inflation. As a result, government leaders came to concentrate more on controlling inflation than on combating recession by limiting spending, resisting tax cuts, and reining in growth in the money supply.

Ideas about the best tools for stabilising the economy changed substantially between the 1960s and the 1990s. In the 1960s, government had great faith in fiscal policy – manipulation of government revenues to influence the economy. Since spending and taxes are controlled by the President and the U.S. Congress, these elected officials played a leading role in directing the economy.

In recent years, the primary economic concerns have centered on: high national debt (\$10 trillion, October, 2008), high corporate debt (\$9 trillion), high mortgage debt (over \$10 trillion as of 2005 year-end), high unfunded Medicare liability (\$30 trillion), high unfunded Social Security liability (\$12 trillion), high external debt (owed to foreign lenders), high trade deficits, and a serious deterioration in the United States net international investment position (NIIP).

The U.S. economy maintains a relatively high GDP per capita, with the caveat that it may be elevated by borrowing, a low to moderate GDP growth rate, and a low unemployment rate, making it attractive to immigrants worldwide.

The promise of high wages brings many highly skilled workers from around the world to the United States. Labour mobility has also been important to the capacity of the American economy to adapt to changing conditions.

In the United States, the corporation has emerged as an association of owners, known as stockholders, who form a business enterprise governed by a complex set of rules and customs. Brought on by the process of mass production, corporations, such as General Electric, have been instrumental in shaping the United States. Through the stock market, American banks and investors have grown their economy by investing.

While consumers and producers make most decisions that mould the economy, government has a powerful effect on the U.S. economy. Strong government regulation in the U.S. economy started in the early 1900s with the rise of the Progressive Movement; prior to this the government promoted economic growth through protective tariffs and subsidies to industry, built infrastructure, and established banking policies, including the gold standard, to encourage savings and investment in productive enterprises.

6.1.3 Government Intervention: Regulation and Control

Some efforts seek, either directly or indirectly, to control prices. Traditionally, the government has sought to prevent monopolies such as electric utilities from raising prices beyond the level that would ensure them extremely large profits. At times, the government has extended economic control to other kinds of industries as well. In the years following the Great Depression, it devised a complex system to stabilise prices for agricultural goods, which tend to fluctuate wildly in response to rapidly changing supply and demand.

Another form of economic regulation, antitrust law, seeks to strengthen market forces so that direct regulation is unnecessary. The government and, sometimes, private parties have used antitrust law to prohibit practices or mergers that would unduly limit competition.

The U.S. has one of the most highly regulated banking environments in the world; however, many of the regulations are not safety and soundness related, but is instead focused on privacy, disclosure, fraud prevention, anti-money laundering, anti-terrorism, anti-usury lending, and promoting lending to lower-income segments.

Monetary policy

The federal government attempts to use both monetary policy and fiscal policy to maintain low inflation, high economic growth, and low unemployment. A relatively independent central bank, known as the Federal Reserve, was formed in 1913 to provide a stable currency and monetary policy. The U.S. dollar has been regarded as one of the most stable currencies in the world and many nations back their own currency with U.S. dollar reserves.

Social regulations

Since the 1970s, government has also exercised control over private companies to achieve social goals, such as improving the public's health and safety or maintaining a healthy environment. For example, the Occupational Safety and Health Administration provide and enforce standards for workplace safety, and in the case of the United States Environmental Protection Agency provide standards and regulations to maintain quality of air, water, and land resources.

While leaders of America's two most influential political parties generally favoured economic deregulation during the 1970s, 1980s, and 1990s, there was less agreement concerning regulations designed to achieve social goals. Social regulation had assumed growing importance in the years following the Depression and World War II, and again in the 1960s and 1970s. During the 1980s, the government relaxed labour, consumer and environmental rules based on the idea that such regulation interfered with free enterprise, increased the costs of doing business, and thus contributed to inflation.

Direct services

Each level of government provides many direct services. The federal government, for example, is responsible for national defense, backs research that often leads to the development of new products, conducts space exploration, and runs numerous programmes designed to help workers develop workplace skills and find jobs (including higher education). Government spending has a significant effect on local and regional economies and even on the overall pace of economic activity.

Direct assistance

Government also provides many kinds of help to businesses and individuals. It offers low-interest loans and technical assistance to small businesses and it provides loans to help students attend college. Government-sponsored enterprises buy home mortgages from lenders and turn them into securities that can be bought and sold by investors, thereby encouraging home lending. Government also actively promotes exports and seeks to prevent foreign countries from maintaining trade barriers that restrict imports.

Social Security, which is financed by a tax on employers and employees, accounts for the largest portion of Americans' retirement income. The Medicare programme pays for many of the medical costs of the elderly. The Medicaid programme finances medical care for low-income families.

National budget

National budget is an instrument used to control and regulate the economy and provides direction for savings and investment. As of January 2, 2008, the total U.S. federal debt was approximately \$9.20 trillion or about \$79,000 on average for each of the 117 million American taxpayers. The borrowing cap debt ceiling as of 2005 stood at \$8.18 trillion. In March 2006, Congress raised that ceiling by an additional \$0.79 trillion to \$8.97 trillion, which is approximately 68 per cent of GDP. Congress has used this method to deal with an encroaching debt ceiling in previous years, as the federal borrowing limit was raised in 2002 and 2003. As of October 4, 2008, the "The Emergency Economic Stabilisation Act of 2008" raises the current debt ceiling to US\$ 11.3 trillion.

The United States is the most significant nation in the world when it comes to international trade. For decades, it has led the world in imports while simultaneously remaining as one of the top three exporters of the world. As the major epicenter of world trade, the United States enjoys leverage that many other nations do not. For one, since it is the world's leading consumer, it is the number one customer of companies all around the world.

Poverty and Income inequality

There is significant disagreement about poverty in the United States, particularly over how poverty ought to be defined. Using radically different definitions, two major groups of advocates have claimed variously that (a) the United States has eliminated poverty over the last century; or (b) it has such a severe poverty crisis that it ought to devote significantly more resources to the problem. The United Nations Development Programme Report 2006 on income equality ranks the United States as tied for 73rd out of 126 countries, as measured by the Gini coefficient.

6.1.4 Basic Ingredients of the U.S. Economy

The first ingredient of a nation's economic system is its natural resources. The United States is rich in mineral resources and fertile farm soil, and it is blessed with a moderate climate. It also has extensive coastlines on both the Atlantic and Pacific Oceans, as well as on the Gulf of Mexico. Rivers flow from far within the

continent and the Great Lakes five large, inland lakes along the U.S. border with Canada provide additional shipping access. These extensive waterways have helped shape the country's economic growth over the years and helped bind America's 50 individual states together in a single economic unit.

The second ingredient is labour, which converts natural resources into goods. The number of available workers and, more importantly, their productivity help determine the health of an economy. Throughout its history, the United States has experienced steady growth in the labour force, and that, in turn, has helped fuel almost constant economic expansion. Until shortly after World War I, most workers were immigrants from Europe, their immediate descendants, or African-Americans whose ancestors were brought to the Americas as slaves. In the early years of the 20th century, large numbers of Asians immigrated to the United States, while many Latin American immigrants came in later years.

Although the United States has experienced some periods of high unemployment and other times when labour was in short supply, immigrants tended to come when jobs were plentiful. Often willing to work for somewhat lower wages than acculturated workers, they generally prospered, earning far more than they would have in their native lands. The nation prospered as well, so that the economy grew fast enough to absorb even more newcomers.

The quality of available labour – how hard people are willing to work? and how skilled they are? – is at least as important to a country's economic success as the number of workers. In the early days of the United States, frontier life required hard work, and what is known as the Protestant work ethic reinforced that trait. A strong emphasis on education, including technical and vocational training, also contributed to America's economic success, as did willingness to experiment and to change.

Labour mobility has likewise been important to the capacity of the American economy to adapt to changing conditions. When immigrants flooded labour markets on the East Coast, many workers moved inland, often to farmland waiting to be tilled. Similarly, economic opportunities in industrial, northern cities attracted black Americans from southern farms in the first half of the 20th century.

Labour-force quality continues to be an important issue. Today, Americans consider "human capital" a key to success in numerous modern, high-technology industries. As a result, government leaders and business officials increasingly stress the importance of education and training to develop workers with the kind of nimble minds and adaptable skills needed in new industries such as computers and telecommunications.

But natural resources and labour account for only part of an economic system. These resources must be organised and directed as efficiently as possible. In the American economy, managers, responding to signals from markets, perform this function. The traditional managerial structure in America is based on a top-down chain of command; authority flows from the chief executive in the boardroom, who makes sure that the entire business runs smoothly and efficiently, through various lower levels of management responsible for coordinating different parts of the enterprise, down to the foreman on the shop floor. Numerous tasks are divided among different divisions and workers. In early 20th-century America, this specialisation, or division of labour, was said to reflect "scientific management" based on system analysis.

Many enterprises continue to operate with this traditional structure, but others have taken changing views on management. Facing increased global competition, American businesses are seeking more flexible organisational structures, especially in high-technology industries that employ skilled workers and must develop, modify,

and even customise products rapidly. Excessive hierarchy and division of labour increasingly are thought to inhibit creativity. As a result, many companies have "flattened" their organisational structures, reduced the number of managers, and delegated more authority to interdisciplinary teams of workers.

6.1.5 Capitalistic Economic Features of United States of America

The United States is often described as a "capitalist" economy, but United States has intervened in their economies to limit concentrations of power and address many of the social problems associated with unchecked private commercial interests. As a result, the American economy is perhaps better described as a "mixed" economy, with government playing an important role along with private enterprise. Although Americans often disagree about exactly where to draw the line between their beliefs in free enterprise and government management, the mixed economy they have developed has been remarkably successful.

Economic power in US is concentrated in corporations instead of individuals. Theoretical capitalism believes in individual as the only organisation, not a corporation. But US capitalism also supports mergers and labour unions. US unions are exempted from prosecution.

Capitalism allows firms to have political power to influence other institutions but some believe that the US has power that was taken from the pure capitalist system. Mergers of individual workers joined together to gain a better bargaining position. American capitalism allows owners the right to form monopolies (sellers) and workers to form unions. Thus there are both sellers' monopolies and buyers' monopsonies.

In U S we see provision of public goods (goods provided by society as a whole) is made by the state and the examples are defence and aid programmes government uses legal coercion to supply public goods (e.g., taxes)

A central feature of the U.S. economy is the economic freedom afforded to the private sector by allowing the private sector to make the majority of economic decisions in determining the direction and scale of what the U.S. economy produces. This is enhanced by relatively low levels of regulation and government involvement, as well as a court system that generally protects property rights and enforces contracts.

Check Your Progress 1

1) Give an account of economic history of USA.

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2) How government interventions regulate and control USA economy?

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3) What are the basic ingredients of the USA economy?

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4) What are the capitalistic features of USA Economy?

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6.2 CAPITALISTIC APPROACH: EXPERIENCE OF JAPAN

6.2.1 Brief History of Japanese Economy

Japan is the second largest economy in the world. After the United States, Banking, insurance, real estate, retailing, transportation, telecommunication and construction are all major industries. Japan has a large industrial capacity and is home to some of the largest, leading and most technologically advanced producers of motor vehicles, electronic equipment, machine tools, steel and nonferrous metals, ships, chemical, textiles and processed foods.

From 1868, Meiji period launched economic expansion. Meiji rulers embraced the concept of a free market economy and adopted British and North American forms of free enterprise capitalism. Japanese went to study overseas and Western scholars were hired to teach in Japan. Many of today's enterprise were founded at the time. Japan emerged as the most developed nation in Asia.

From the 1960s to the 1980s, overall real economic growth has been called a "Japanese miracle" 10 per cent average in the 1960s and a 4.0 percent average in the 1980s. Growth slowed markedly in the 1990s, largely because of the after-effects of Japanese asset price bubble and domestic policies intended to wring speculative excesses from the stock and real estate markets. Government efforts to revive economic growth met with little success and were further hampered by the global slowdown in 2000. The economy showed strong signs of recovery after 2005.

As of 2001, Japan's shrinking labor force consists of some 67 million workers. Japan has a low unemployment rate, around 4.0 per cent, Japan's GDP per hour worked is the world's 18th highest as of 2006. It is home to some of the world's largest banks and the Tokyo Stock Exchange, known for Nikkei 225, stands as the second largest in the world by market capitalisation.

Japan's exports amounted to 4,210 U.S dollars per capita in 2005. Japan's main export markets are the United States 22.8 per cent, the European Union 14.5 per cent, China 14.3 per cent, South Korea 7.8 per cent, Taiwan 6.8 per cent and Hong Kong 5.6 per cent (for 2006). Japan's main exports are transportation equipment, motor vehicles, electronics, electrical machinery and chemicals. Japan's main import markets are China 20.5 per cent, U.S 12.0 per cent, the European Union 10.3 per cent, Saudi Arabia 6.4 per cent, UAE 5.5 per cent, Australia 4.8 per cent, South Korea 4.7 per cent and Indonesia 4.2 per cent (for 2006). Japan's main imports are

machinery and equipment, fossil fuels, foodstuffs (in particular beef), chemicals, textiles and raw materials for its industries. By market share measures, domestic markets are the least open of any OECD country. Junichiro Koizumi administration commenced some pro-competition reforms and foreign investment in Japan has soared recently.

Japan has found its economy growing slowly for the past decade, after a century extraordinarily rapid economic growth. A primary reason for slow growth was mismanaged macroeconomic policy, which produced first a speculative bubble and then the deflation of a pricked bubble. But Japan also has problems with microeconomic policy, as the policies Japan designed for industrial catch-up fail to apply to an economy that has now for decades been at the front ranks of the developed economies. Japan's developmental state used strategies of industrial targeting and managed competition to enable Japan to catch up with more advanced economies. While these strategies worked well while Japan was behind the most advanced economies, they have not been successful at promoting radical innovation or at lowering domestic prices. Also, the strategic part of targeting has been lost, as Japan has tended to protect old industries rather than promote new ones.

6.2.2 Capitalistic Features of Japanese Economy

The unique characteristics of the Japanese model of economic development, such as lifetime employment, on-the-job training and intra-firm labour mobility, close involvement of banks in client firm management and strong administrative supervision of the corporate sector by the powerful Ministry of International Trade and Industry (MITI), were believed to be the secrets of success that helped the country to become the second largest economic power in the world from the rubble of the Second World War in only 40 years.

6.2.3 Protection of Corporations

To achieve its ultimate goal, the Japanese government protected and promoted the interests of the big Japanese corporations and utilised the power of bureaucrats to guide development projects. As Pempel and Muramatsu observe, economic development has been persistently pursued as a national goal by Japan's business and political leaders since the Meiji Restoration in 1868 and with renewed enthusiasm after the World War Second. Achieving high levels of national economic growth has been the touchstone against which the long-time viability of politicians and the competence of national bureaucrats are measured.

6.2.4 Developmentalism

Japan is one of the first Asian countries that consciously adopted the ideology of developmentalism in order to survive severe competition among imperialist states in the 19th century. This process was interrupted by World War II. After the war, Japan reinstated developmentalism in order to restore its war-torn economy. Before the 1980s, Japan had reached the status of a fully industrialised nation. In terms of economic power Japan became on par with Western industrialised nations. This success story was dubbed the "Japanese Miracle".

The pursuit of economic development in Japan was often conducted at the expense of other policy agendas, such as the protection of nature and environmental conservation. As a result, the country's rapid economic expansion during the 1950s and 1960s was accompanied by an equally rapid deterioration of environmental conditions. Nevertheless, in the 1970s, the importance of protection of nature and the need for environmental conservation were increasingly recognised not only by Japan's ruling elite, who had relentlessly pursued developmentalism, but also by the general public.

6.2.5 Organisation Oriented System

In Japan there exists organisation oriented system rather than market-oriented one. The system extends to all workers' conditions of service (unlike enjoyed only by privileged managerial workers in the American or British system); it also extends to private businesses patterns of employment which, even for managerial workers, are found only in the civil service, the police and the army.

Japan as a fiercely competitive economy whose success is to be attributed to the entrepreneurial vigor and healthy lust for profits of Japanese private enterprise managers – never to anything as unfair as 'Japan Inc'. type government direction or government subsidies. The competitive spirit is certainly there. The major electronics companies work their engineers to nervous breakdowns trying to get some new hyper gimmicked video recorder on the market a few weeks ahead of the competition, thereby gaining two or three percentage points of market share.

Check Your Progress 2

- 1) Give a brief history of Japanese Economy.

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- 2) What are the capitalistic features you find in Japanese economy?

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6.3 CAPITALISTIC APPROACH: EXPERIENCE OF WESTERN EUROPE

Western Europe at its most general meaning refers the countries in the West of Europe. The concept at different times has had different meanings, at times including political and cultural considerations as well as geographical. Following are the important countries that include the nations of Western Europe: The United Kingdom, France, Germany, Italy, Belgium, Netherlands, Luxembourg, Portugal, Spain, and Greece.

Against the world background of a continual rise in the colonial revolution, an ever deepening crisis in the Soviet bureaucracy, and the temporary stabilisation of capitalism in the imperialist countries due to the betrayal of the revolutionary upsurge of 1943-48 by the reformist and Stalinist leaderships, the possibility opened to capitalism of a new phase of economic growth in these countries.

In 1963 the economic situation of European capitalism began to change slowly but definitely. A phase of unprecedented expansion of the productive forces, of industrial growth and of the national income in all the European capitalist countries gradually gave way to a phase of uneven development, in which various capitalist countries have undergone contradictory evolution.

A high level of employment, production and income still constitutes the prevailing feature of the capitalist economy of Western Europe as a whole. Full employment still exists in many countries. A large number of workers from more backward regions or countries (Southern Italy, Spain, Greece, Portugal, and Turkey) continue to be absorbed by the demand for labour in countries or regions where expansion is continuing. West Germany and Switzerland particularly are in the process of becoming genuine melting pots for hundreds of thousands of foreign workers, limited, as in most West European countries, to the least qualified and most repellent jobs, and living under conditions that have little in common with the so-called affluent society.

The slowing down of growth and the rise in international competition make it difficult to increase wholesale prices of industrial products, while full employment and even a labour shortage favour a rise in wages, even partially reducing the rate of exploitation of labour power (due to greater shifting of labour from plant to plant, lowered "work discipline," a rise in wild-cat strikes and all kinds of work stoppages, etc.).

In general the workers have utilised these favorable conditions to gain considerable wage increases. In both 1963 and 1964 these increases came to around 10 per cent or more in countries like Italy, Holland, Belgium, etc. In 1963, a slower rise in wages aided the British capitalists in regaining some previously lost markets, especially in Europe; but in 1964 the drive was not followed up. This was due particularly to a lower general level of productivity than that of West Germany.

Under the prevailing conditions of economic expansion – even though it is slowed down – the trend towards the progressive economic integration of the capitalist countries of Western Europe, above all the countries of the Common Market, has continued, insofar as it corresponds in particular to the inevitable imperatives of productive technique (size of enterprise required to cross the threshold of profitability), so that markets greatly transcending the frontiers of the national state become a necessity.

During the long period of capitalist prosperity that unfolded in Western Europe, traditional bourgeois democracy, far from being revived or consolidated, continued to follow its process of slow decline. This decline corresponds in particular to an objective situation in which the key forces – in principle place, the big capitalist monopolies, the banks and finance capital decide on a series of questions involving political, economic, financial, monetary, commercial and sometimes even cultural policies, which were formerly prerogatives of parliaments.

During the past five years (2002-06) the European labour movement continued to undergo the influence of international factors determining the broad lines of the evolution of world politics: the continuation of the colonial revolution which has gained new spectacular victories; the deepening of the crisis of the Stalinist bureaucracy, which resulted in the Sino-Soviet conflict and the prolonged crisis in the international Communist movement; the prolonged period of boom in the United States which bolstered the capitalist prosperity in capitalist Europe, etc.

The UK, a leading trading power and financial center, deploys an essentially capitalistic economy, one of the quartets of trillion dollar economies of Western Europe. Over the past two decades the government has greatly reduced public ownership and contained the growth of social welfare programmes. Agriculture is intensive, highly mechanised, and efficient by European standards, producing about 60 per cent of food needs with only 1 per cent of the labour force.

In the late 1990s, France's economy grew faster than the European average, allowing the Socialist government to indulge in such goodies as the 35-hour work week.

But the country's cherished social model has in recent years proved a strong disincentive to growth and to job creation. Unemployment is double that in Britain and special public-sector pensions and rising health-care costs are straining the public finances.

Discontent with the economy and the government's handling of it played a large part in France's rejection of the EU constitution. But, as usual in France, economic reforms smacking of liberalism have met strong resistance: in the spring of 2006, after weeks of protests, the government dropped a proposed loosening of first-job contracts. Nicolas Sarkozy, elected president in May 2007, has promised reforms, although his first budget reduced neither public spending nor public debt, and his movement toward public-sector pension reforms provoked strikes.

Italy provides an interesting case study to examine the discussion about the persistence, adaptability or transformation of national models of capitalism in the face of external pressures. First, economic governance in Italy does not fit easily or neatly into the various models of capitalism. It is based on non market forms of regulation, yet it lacked many important elements such as active labour market structures, cohesive social partners and strong political institutions. Taken together, the various elements of Italian capitalism constitute a complex system that has retained elements of what might be called 'dysfunctional state capitalism'.

Check Your Progress 3

- 1) What are the experiences of Western Europe with reference to the capitalistic approach to development?

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6.4 LET US SUM UP

In this unit we have discussed the experience of capitalistic approach to economic development in USA, Japan and the Western Europe. We have seen economic history of USA, basic ingredients of the USA economy and also the capitalistic features of USA, Japan and Western Europe. Further, history of Japanese economy and the working of the economy of Japan and the Western Europe are also discussed.

6.5 KEY WORDS

- Economic features** : It refers to the features of the economy, which highlights that USA, Japan and the Western Europe have capitalistic approach to economic development.
- Economic history** : Refers to the historical experiences of economic development.
- USA Economy** : Economy of United State of America.
- Japanese Economy** : Refers to the economy of Japan.

6.6 SOME USEFUL BOOKS

- 1) Carl Mosk (2001): "*Japanese Industrial History: Technology, Urbanization and Economic Growth*", M.E Sharpe.
- 2) Gide.C and Rist G, (1956): "*A History of Economic Doctrines*", second edition, George Harrop and Company, London.
- 3) Penelope Frandos (1992): "*Japanese Economic Development: Theory and Practice*", Rutledge.
- 4) Schumpeter J A (2003): "*Theory of Economic Development*", Springer US.

6.7 ANSWER OR HINTS TO CHECK YOUR PROGRESS

Check Your Progress 1

- 1) The economic history of the United States has its roots in European settlements in the 16th, 17th, and 18th centuries. The American colonies progressed from marginally successful colonial economies to a small, independent farming economy, which in 1776 became the United States of America. In 230 years the United States grew to a huge, integrated, industrialised economy that makes up over a quarter of the world economy. The main causes were a large unified market, vast areas of highly productive farmlands, vast natural resources and an entrepreneurial spirit and commitment to investing in material and human capital.
- 2) Government control and regulates economy by different methods like, measures to control prices. Another form of economic regulation, antitrust law, seeks to strengthen market forces so that direct regulation is unnecessary. Many of the regulations focused on privacy, disclosure, fraud prevention, anti-money laundering, anti-terrorism, anti-usury lending, and promoting lending to lower-income segments.
- 3) The basic ingredient of USA economic system is its natural resources. The United States is rich in mineral resources and fertile farm soil, and it is blessed with a moderate climate. It also has extensive coastlines on both the Atlantic and Pacific Oceans, as well as on the Gulf of Mexico. The second ingredient is labour, which converts natural resources into goods. The number of available workers and, more importantly, their productivity help determine the health of an economy.
- 4) Economic power in US is concentrated in corporations. A central feature of the U.S. economy is the economic freedom afforded to the private sector. American capitalism allows owners the right to form monopolies (sellers) – unions are monopsonies (buyers) as monopolies.

Check Your Progress 2

- 1) Japan is the second largest economy in the world, after the United States. Banking, insurance, real estate, retailing, transportation, telecommunications and construction are all major industries. Japan has a large industrial capacity and is home to some of the largest, leading and most technologically advanced producers of motor vehicles, electronic equipment, machine tools, steel and nonferrous, metals, ships, chemicals, textiles and processed foods.

From 1868, Meiji period launched economic expansion. Meiji rulers embraced the concept of a free market economy and adopted British and North American forms of free enterprise capitalism. From the 1960s to the 1980s, overall real economic growth has been called a "Japanese miracle" 10.0 per cent average in the 1960s and a 4.0 per cent average in the 1980s.

- 2) The unique characteristics of the Japanese model of economic development, such as lifetime employment, on-the-job training and intra-firm labour mobility, close involvement of banks in client firm management and strong administrative supervision of the corporate sector by the powerful Ministry of International Trade and Industry (MITI), were believed to be the secrets of success that helped the country to become the second largest economic power in the world from the rubble of Second World War in only 40 years.

Check Your Progress 3

- 1) Western Europe include the union of Western Europe United Kingdom, France, Germany, Italy, Belgium, Netherlands, Luxembourg, Portugal, Spain, and Greece. Against the world background of a continual rise in the colonial revolution, an ever deepening crisis in the Soviet bureaucracy, and the temporary stabilisation of capitalism in the imperialist countries due to the betrayal of the revolutionary upsurge of 1943-48 by the reformist and Stalinist leaderships and the possibility opened to capitalism of a new phase of economic growth in these countries.

6.8 EXERCISES

- 1) Explain the economic development experience of USA.
- 2) Explain the economic development experience of Japan.
- 3) Explain the economic development experience of Western Europe.

UNIT 7 THE SOCIALISTIC APPROACH

Structure

- 7.0 Objectives
- 7.1 Introduction
- 7.2 History of Socialism
 - 7.2.1 Marxism and the Socialist Movement
 - 7.2.2 Social Democracy (1917)
 - 7.2.3 Socialism versus Fascism
 - 7.2.4 Socialism and Communism (1917-39)
 - 7.2.5 Social Democracy (1945-70)
- 7.3 Socialist Revolution
 - 7.3.1 Transitional Period from Capitalism to Socialism
- 7.4 The Socialist Command Economy
- 7.5 The Socialistic Mode of Production
- 7.6 How Socialism Copes with Scarcity?
- 7.7 Let Us Sum Up
- 7.8 Key Words
- 7.9 Some Useful Books
- 7.10 Answer or Hints to Check Your Progress
- 7.11 Exercises

7.0 OBJECTIVES

After going through this unit, you will be able to:

- discuss the socialistic approach to development;
- narrate historical experience of socialism, and socialist revolution; and
- explain the functioning of socialist command economy and the socialistic mode of production.

7.1 INTRODUCTION

Throughout the history of the Western world, various ideologies have proven as influential as to give rise to assorted “isms” that change society, namely, the rise and support of socialism has been a major component to the make up of Western history in the 19th and 20th centuries. An investigation into the development of socialism will prove that its popularity, support and even criticism came as a result of certain milestones. These milestones serve as turning points in the ideology’s history, and without them it could easily be presumed that the philosophy would never have produced such influential results. In addition, such an investigation will prove these milestones were joined with various interactions between the philosophers and the political reality of assorted nations. This interaction proved to be the roots that allowed socialism to bloom into its entirety.

Socialism refers to a broad set of economic theories of social organisation advocating state or collective ownership and administration of the means of production and distribution of goods, and an egalitarian society characterised by equal opportunities for all individuals.

The socialist doctrine demands state ownership and control of the fundamental means of production and distribution of wealth, to be achieved by reconstruction of the existing capitalist or other political system of a country through peaceful, democratic, and parliamentary means. The doctrine specifically advocates nationalisation of natural resources, basic industries, banking and credit facilities, and public utilities. It places special emphasis on the nationalisation of monopolised branches of industry and trade, viewing monopolies as inimical to the public welfare. It also advocates state ownership of corporations in which the ownership function has passed from stockholders to managerial personnel. Smaller and less vital enterprises would be left under private ownership, and privately held cooperatives would be encouraged.

Some political movements calling themselves socialist, however, insist on the complete abolition of the capitalist system and of private profit, and at the other extreme are socialist programme having objectives entailing even fewer changes in the social order than those outlined above. The ultimate goal of all socialists, however, is a classless cooperative commonwealth in every nation of the world.

7.2 HISTORY OF SOCIALISM

The word socialism came into English from French in the 1820s, but the idea that goods should be held in common and that all men should be equal is much older. Quasi-socialist elements can be identified in Plato's Republic, the Sermon on the Mount, the millenarian movements of the Middle Ages and Thomas More's Utopia. Socialist ideas were certainly current among the Levellers and other sects of the English revolution of the 1640s and the more radical sans culottes of the French revolution of the 1790s, though they never achieved real influence. As a coherent body of ideas, socialism dates from the early 19th century.

The early socialists were Utopians they developed visions of ideal societies based on absolute equality, in which humans co-operated in production for the benefit of all without the need for material incentives, and in which the state was abolished in favour of a system of self-government, or (in a positive sense) anarchy.

The emergence of socialist ideas in Britain and France, and later in Germany and Italy, was a consequence of the industrial revolution. In these countries, the development of manufacturing industry, and related industries such as coal-mining and the railways, produced an industrial working class, referred to by socialists as the proletariat workers who had nothing to sell but their labour. The misery of the industrial workers in the unregulated economies of the early 19th century provoked anger among many observers, and the formulation of socialist doctrines was an attempt to devise a way of producing wealth without such crude exploitation.

7.2.1 Marxism and the Socialist Movement

In Germany liberalism suffered a terrible defeat in the failed revolution of 1848, and this gave rise to a new strain of socialist thought, articulated by Karl Marx and Friedrich Engel's in the Manifesto of the Communist Party (1848). Marx and Engels developed a body of ideas which they called "scientific socialism", and which their followers called Marxism. Marxism contained both a theory of history (historical materialism) and a theory of society. Unlike the utopian socialists, Marx

confronted the question of power. He believed that capitalism could only be overthrown by means of a revolution, to be followed by the establishment of a dictatorship of proletariat.

In Marx's theory, "socialism" referred to the stage of history and class structure immediately following the revolution, in which power would pass to the proletariat. According to Marx, once private property had been abolished, the state would then "wither away", and humanity would move on to a higher stage of society, "communism". This distinction continues to be used by Marxists, and is the cause of much confusion. No Marxist, for example, ever claimed that the Soviet Union was a communist society, even though it was ruled by a Communist Party for 70 years.

Having developed a body of ideas, socialists naturally sought to put them into practice. Socialist political groups were formed as early as the 1830s, but they failed to make real headway among the workers, who were more interested in forming trade unions and making immediate economic gains within the capitalist system. The socialist groups also tended to be quarrelsome and suffer frequent splits.

In 1864, the First International, (or International Working Men's Association) was founded in London, at a conference addressed by Marx. Most of the groups represented at this meeting had little real existence, but from this time on they grew rapidly, especially in France and Germany.

The Second International was established in Paris in 1893, by which time socialist parties were active in most European countries and were beginning to achieve some electoral successes in countries where elections were held and the working class was able to vote. This International, however, was divided between the followers of Marx and the anarchists, led by the Russian Mikhail Bakunin.

7.2.2 Social Democracy (1917)

One of the first modifications of Marx's definition of means to achieve socialism occurred in the late 19th century, when many political theorists broke with the Marxist notion that revolution was the only way to advance beyond capitalism and that socialism was incompatible with democracy.

In Germany, where the Social Democratic Party (SPD) in the 1890s became the largest and most powerful socialist party in Europe, the next generation of leaders, such as August Bebel and Eduard Bernstein, went further arguing that once full democracy had been achieved, a transition to socialism by parliamentary means was both possible and more desirable than revolutionary change.

In 1914, the outbreak of World War I led to a crisis in European socialism. Contrary to the fondly held beliefs about the international solidarity of the proletariat, the working classes of the various belligerents rushed to go to war with each other, and the socialist parties of Germany, France and Britain were dragged along behind, although some leaders, like Ramsay MacDonald in Britain and Karl Liebknecht in Germany, opposed the war from the start.

The Russian Revolution of 1917 proved Lenin right, in the sense that a revolution turned out to be the only way to get Russia out of the war. It also seemed to prove that he was right on the question of revolution: Russia was certainly the only country in the world where socialists had taken power. In some countries, particularly Britain and the British Dominions, labour parties were formed. These were parties formed by and controlled by the trade unions, rather than formed by groups of socialist activists who then appealed to the workers for support.

7.2.3 Socialism versus Fascism

During the 1920s and 1930s Socialist and Communist parties were in continuous conflict. One point of contention was the question of support for the USSR. Socialists castigated Communists as agents of the Soviet Union and traitors to their own countries. Also during the 1920s and 1930s, Fascist regimes in Germany and Italy caused both socialists and Communists to develop new tactics. Attempts were made in several countries to form a united front of all working-class organisations opposed to fascism, but the movement had limited success, even in France and Spain, where it did well in the 1936 elections.

Failure of the Communists and socialists of Germany to unite is regarded as one cause of the success of the National Socialists. The fragile alliance that was achieved between socialists and Communists in some countries during this "Popular Front" period was destroyed in 1939 by the conclusion of a non-aggression pact between Germany and the USSR. Socialists condemned this act as a demonstration of the community of interest between two totalitarian governments. In August 1939, Germany invaded Poland, precipitating World War II, and socialists in the Allied countries immediately expressed full support for their governments.

7.2.4 Socialism and Communism (1917-39)

The aftermath of the First World War produced an upsurge of radicalism in most of Europe and also as far a field as the United States and Australia. The initial success of the Russian Revolution inspired other revolutionary parties to attempt the same thing. In the chaotic circumstances of postwar Europe, with the socialist parties divided and discredited, Communist revolutions across Europe seemed a possibility. By the mid 1920s, however, the impetus had gone out of the revolutionary forces in Europe, and the orthodox socialist parties had regained their dominance over the working-class movement in most countries.

After 1929, Stalin led the Soviet Union into a "higher stage of socialism". Agriculture was collectivised, at the cost of a massive famine and millions of deaths among the resistant peasantry. The surplus squeezed from the peasants was spent on a programme of crash industrialisation, guided by the Communist Party through the Five Year Plan. This programme produced some impressive early results, though at enormous human costs. Later studies by economists, however, showed that the pace of industrialisation in the Soviet Union was no faster than it was, for example, in Japan or the United States under capitalism, and that the use of resources, material and human, in the Soviet Union was very wasteful.

The Great Depression, which began in 1929, seemed to socialists and Communists everywhere to be the final proof of the bankruptcy, literally as well as politically, of capitalism. But socialists were unable to take advantage of the Depression to either win elections or stage revolutions.

7.2.5 Social Democracy (1945-70)

As a result of the failure of the Popular Fronts and the inability of Britain and France to conclude a defensive alliance against Hitler, Stalin again changed his policy in August 1939 and signed a non-aggression pact, the Molotov-Ribbentrop Pact, with Nazi Germany.

The greatest postwar victory of the democratic socialist parties was the election victory of the British Labour Party led by Clement Attlee in 1945. Socialist (and in some places Communist) parties also dominated postwar governments in France, Italy, Czechoslovakia, Belgium, Norway and other European countries. The Social Democratic Party had been in power in Sweden since 1932.

The Second International, which had been based in Amsterdam, ceased to operate during the war. It was refunded as the Socialist International at a congress in Frankfurt in 1951. Since Stalin had dissolved the COM intern in 1943, this was now the only effective international socialist organisation. In the 1960s and 1970s new social forces began to change the political landscape in the western world. The long postwar boom and the rapid expansion of higher education produced, as well as rising living standards for the industrial working class, a mass university-educated white collar workforce, which began to break down the old socialist-versus-conservative polarity of European politics.

Another manifestation of this changing social landscape was the rise of mass radical student movement, both in the United States — where it was driven mainly by opposition to the Vietnam War, and in Europe. This was the first left-wing upsurge in the United States since the 1930s, but neither there nor in Europe did the traditional parties of the left either lead the movement. Instead a collection of Trotskyist, Maoist and anarchist groups arose. They reached the peak of their influence in 1968, when riots amounting almost to an insurrection broke out in Paris, and there were also major disturbances in Chicago, Berlin and other cities. In the short-term these movements provoked a conservative backlash, seen in De Gaulle's 1968 election victory and the election of Richard Nixon in the United States. But in the 1970s, as the ultra-left groups faded away, the socialist and Communist parties gained ground again.

British Labour had already returned to office under Harold Wilson in 1964, and in 1969 the German Social Democrats came to power for the first time since the 1920s under Willy Brandt. In France Francois Mitterrand buried the corpse of the old socialist party, the SFIO, and founded a new Socialist Party in 1971, although it would take him a decade to lead it to power. Labour governments were elected in both Australia and New Zealand in 1972, and the Austrian Socialists under Bruno Kresky formed their first postwar government in 1970. The British Labour government carried out some nationalisation, but in general these social democratic governments confined themselves to measures of liberal social reform and wealth-redistribution through state welfare and taxation policy. They could not win elections without a substantial measure of middle-class support, and middle-class voters were not interested in traditional socialism.

7.3 SOCIALIST REVOLUTION

The first and lower phase of communist society, or socialism, is ushered in by a socialist revolution. The downfall of capitalism and the establishment of the first phase of communist society began with the Great October socialist revolution in Russia in 1917. Later, the Soviet Union, the first country in the world to have built socialism, has been joined by many other nations on the road of building a new society.

The socialist revolution is an inevitable result of society's development, prepared for by capitalism, in the heart of which the objective and subjective prerequisites for the socialist revolution mature. Under capitalism, productive forces attain a high degree of development. Production acquires a social character as, owing to the concentration of production, increase in the social division of labour, greater specialisation and cooperation of production, sectors and enterprises; all parts of social production become interdependent, and the world capitalist economy is formed. Productive forces and the social character of production call for an appropriate social mode of appropriation of the material goods and for socialist relations of production.

At the same time, the working class grows in capitalist society and becomes increasingly consolidated and well organised. This is a formidable social force capable of overthrowing capitalist rule in an alliance with the people of town and the countryside and under the guidance of its Marxist-Leninist party. This is how the subjective prerequisite for the socialist revolution emerges and matures.

7.3.1 Transitional Period from Capitalism to Socialism

The historical period between capitalism and socialism is called the transitional period. The need for it is determined by the specifics of the socialist revolution and its distinctions from the bourgeois revolution. The latter begins and ends with the bourgeoisie taking power. The seizure of power by the proletariat in an alliance with the working people only initiates the socialist revolution. The bourgeois revolution finds the capitalist economic basis (the system of capitalist production relations) ready made, as it had taken shape within the heart of feudal society. Capitalist enterprises spring up and develop side by side with feudal ones, because both are based on different forms of the same sort of private ownership of the means of production.

The working class in alliance with the working people in town and village overthrows the capitalist government and takes power into its own hands in order to build a socialist economy. This takes a definite period of time, the transitional period, during which the material and technical base of socialism is created and capitalist production relations are destroyed and replaced by socialist ones. Enterprises are organised on a new social foundation. A cultural revolution is put through. The working class prepares itself as a force capable of guiding society.

Check Your Progress 1

- 1) What do you mean by Socialism? Explain its evolution.

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- 2) Write a note on socialist revolution.

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7.4 THE SOCIALIST COMMAND ECONOMY

The socialist command economy is characterised by public ownership of the means of production, collective determination of economic decisions, and the allocation of resources by commands issued by the planning elite. Under this system all decisions with respect of production, investment, and distribution are made by the state planners. These decisions are formulated in a plan which forms the blueprint for the activity of individual economic units. The plan rather than the market coordinates the production of enterprises.

In order to formulate a plan, the economic leaders must have knowledge of the objective features of the economy, such as plant capacity, availability of raw materials, the size and composition of the labour force, and consumer preferences in order to select feasible production patterns. This information must flow from the producing units at the bottom to the planners at the top. Once decisions are made by the planners, they must be communicated to the enterprises.

In a pure command economy, individuals own no resources, are directed to their places of employment, and are assigned state determined allotments of consumer goods. Firms or enterprises are publicly owned and operate in accord with state directives. They produce the quantity and assortment of goods specified in the plan using the quantity and combination of inputs also specified in the plan.

The primary feature of the command economy is the centralisation of decision making. There is no horizontal communication between producing and consuming units. All communication is vertical. i.e., between the individual economic unit and the planning agency. No economy has ever existed which has been organised solely by the command principle. Even the Soviet economy under Stalin, considered the archetype of the command system, contained elements of private property (small private peasant plots), individual decision making (in the allocation of labour among enterprises), and the use of the market (in the allocation of consumer goods). We may consider the operation of the Soviet economic system, however, as the best representative of a command system in practice.

In addition to the two pure models of economic organisation, there are also economic systems which combine elements of both capitalism and the command economy. Two well known examples are market socialism and the mixed economy. Both those systems contain elements in common and can only be distinguished by the relative intensity of their reliance on markets, private property, and individual decision making.

Check Your Progress 2

- 1) What are the characteristics of the socialist command economy?

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7.5 THE SOCIALISTIC MODE OF PRODUCTION

The socialist economic structure in the transitional period is represented by the state owned industrial, agricultural, transport, and commercial enterprises and banks, and also cooperative enterprises.

The socialist production structure emerges in two ways: in the process of the socialist nationalisation of the means of production belonging to capitalist and landlords, and as a result of small producers in town and country forming cooperatives. The choice of ways depends on the fact that the socialist revolution takes place when there are several forms of private ownership of the means of production viz., big ownership by capitalists and landlords and small ownership, based on personal work. Different approaches are needed for transforming the various kinds of property into socialist property.

Socialist nationalisation abolishes the economic domination of the capitalist and lays the material and socio-economic foundations for organising and operating socialist enterprises, providing the economic basis for the dictatorship of the proletariat and making the power of the working class more stable and durable.

Nationalisation conducted by a socialist state in the transitional period differs fundamentally from capitalist nationalisation, which does not abolish capitalist production relations, so that the exploitation of man by man remains. Capitalist countries are willing to nationalise in the interest of the capitalist class. Socialist nationalisation provides all the conditions necessary for the socialist socialisation of production and the emergence of socialist forms of economy, with their socialist production relations. The exploitation of wage labour is abolished. As a result of socialist nationalisation, a state form of social socialist ownership emerges.

The socialist economic structure plays the leading role in the country's economy during the transitional period. It is a progressive form of production to which the future belongs as the dominant form of social production. The socialist structure predominates during the transitional period in large scale industry, banking and big enterprises in other branches of the economy. Lastly, it enjoys every support from the government, the dictatorship of the proletariat.

Socialist industrialisation is the main link in the building of the material and technical base of socialism. Such industrialisation involves the creation of heavy industry, including its main branch engineering, and the equipment of enterprises in all branches of the national economy with machinery. The experience of building socialism has shown that industrialisation is taking place to some degree in all countries building socialism. This is because, in the countries that have experienced a socialist revolution, heavy industry, engineering, and large scale machine production were either absent, underdeveloped or unevenly developed, that is to say did not embrace all branches of the economy or all parts of the country.

7.6 HOW SOCIALISM COPES WITH SCARCITY?

In a socialistic pattern of economy, the preferences of a group of administrators called planners carry the most weight. Those preferences dictate the activities of the production enterprises. The planners control capital and natural resources, directing them to the uses that satisfy their priorities. The planners also decide what types of jobs will be available, and the state plays a large role in the allocation of the only factor of production owned by households-labour.

The decisions of the planners are formalised in a central plan. A central plan is a detailed economic blueprint that sets out what will be produced, how it will be produced and who it will be produced for, and that establishes a set of sanctions and rewards designed to ensure that the plan is fulfilled as fully as possible.

The central plan is communicated to state owned enterprises which use the factors of production and the available technologies to produce goods and services. These goods and services are supplied to households in accordance with the central plan. The purchases by each individual household are determined by household preferences, but the total amount available is determined by the central plan.

A centrally planned economy has prices, but they do not adjust to make the quantity demanded and supplied equal. Instead, they are set by the planners to achieve social objectives. For example, the prices of staple food products are set at low levels so that even the poorest families can afford an adequate basic diet. The effect of setting such prices at low levels is chronic shortages and long queues. In

such a situation, prices do not provide the main incentives and people respond to the penalties and rewards that superiors impose on and give to their subordinates.

Under socialism, the preferences of the planners dictate the choices that are made. The planners control all the capital and natural resources owned by the state. Planners draw up plans and issue orders that determine how these resources will be used in the production of goods and services. Households decide which goods and services and employ the factors of production required by the central plan. The output of state enterprises is shipped to other enterprises in accordance with the plan. Prices are set by the planners to achieve social objectives and bear no relation to the quantities demanded and quantities supplied. Prices set at low levels for social reasons – as in the case of basic food products – result in chronic shortages.

Check Your Progress 3

- 1) How does socialist mode of production function?

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7.7 LET US SUM UP

In this unit we have discussed the meaning and characteristic features of socialistic pattern of economy. We have seen that the socialism has grown in different stages in its history. These stages we have seen in terms of Marxism and state ownership. We have also seen the development of socialism over the years as an ideological frame for economic development, as an alternative to capitalism. We have also discussed the socialist mode of production.

7.8 KEY WORDS

- Socialism** : Socialism refers to a broad set of economic theories of social organisation advocating state or collective ownership and administration of the means of production and distribution of goods, and an egalitarian society characterised by equal opportunities for all individuals.
- Marxism** : Marx's theory. "Socialism" is referred to as Marxism.

7.9 SOME USEFUL BOOKS

- 1) Gosh and Gosh, (1988): "*Concise History of Economic Thought*" Himalaya Publishing House, Bombay.
- 2) Misra B (1979): "*Capitalism Socialism and Planning*", Second Edition, Oxford Publishing Company Calcutta.
- 3) Devendranath Thakur (1993): "*World Economy Today Recent Trends*", Deep and Deep Publications.
- 4) Gary M Pickersgill and Joyce E Pickersgill (1974): "*Contemporary Economic Systems a Comparative View*", Prentice - Hall, Inc., Englewood Cliffs, New Jersey.

7.10 ANSWER OR HINTS TO CHECK YOUR PROGRESS

Check Your Progress 1

- 1) Socialism refers to a broad set of economic theories of social organisation advocating state or collective ownership and administration of the means of production and distribution of goods, and an egalitarian society characterised by equal opportunities for all individuals.

The early socialists were utopians. They developed visions of ideal societies based on absolute equality, in which humans co-operated in production for the benefit of all without the need for material incentives, and in which the state was abolished in favour of a system of self-government. The emergence of socialist ideas in Britain and France, and later in Germany and Italy, was a consequence of the industrial revolution.

- 2) The downfall of capitalism and the establishment of the first phase of communist society began with the Great October socialist revolution in Russia. The Soviet Union was the first country in the world to have built socialism. Industrial revolution gave a path to socialism as the labour group organised to bargain against the capitalists.

Check Your Progress 2

- 1) The socialist command economy is characterised by public ownership of the means of production, collective determination of economic decisions, and the allocation of resources by commands issued by the planning elite. Under this system all decisions with respect of production, investment, and distribution are made by the state planners.

Check Your Progress 3

- 1) The socialist production structure emerges in two ways: in the process of the socialist nationalisation of the means of production belonging to capitalist and landlords, and as a result of small producers in town and country forming cooperatives.

7.11 EXERCISES

- 1) Explain the meaning of Socialism. Highlight it as an important economic ideology.
- 2) Explain the historical evolution of socialistic approach to economic development.
- 3) Explain the characteristics of socialistic command economy.

UNIT 8 EXPERIENCE OF SOVIET UNION, CHINA AND EASTERN EUROPE

Structure

- 8.0 Objectives
- 8.1 Socialistic Approach: Experience of Soviet Union
 - 8.1.1 Growth of Soviet Economy over the Year
 - 8.1.2 Planning
 - 8.1.3 Economic Development
 - 8.1.4 Agriculture
 - 8.1.5 Foreign Trade and Currency
 - 8.1.6 Forms of Property
 - 8.1.7 Socialistic Features of the Economy of Union of Soviet Socialist Republics
- 8.2 Socialistic Approach: Experience of Peoples Republic of China
 - 8.2.1 Introduction
 - 8.2.2 Growth of Chinese Economy over the Years
 - 8.2.3 Role of Government in Chinese Economy
 - 8.3.4 Market Element in China
 - 8.3.5 Socialist Elements in China
- 8.3 Socialistic Approach: Experience of Eastern Europe
- 8.4 Let Us Sum Up
- 8.5 Key Words
- 8.6 Some Useful Books
- 8.7 Answer or Hints to Check Your Progress
- 8.8 Exercises

8.0 OBJECTIVES

After going through this unit, you will be able to:

- discuss the experience of socialist approach in Soviet Union, Peoples Republic of China and countries in the Eastern Europe.

8.1 SOCIALISTIC APPROACH: EXPERIENCE OF SOVIET UNION

The economy of the Soviet Union was based on a system of state ownership, administrative planning, socialist competition and free labour. The Soviet Union created the modern world's first centrally planned economy.

8.1.1 Growth of Soviet Economy over the Years

From 1928 to 1991 the entire course of the Soviet or USSR economy was guided by a series of Five-Year Plans. Within about 50 years, the nation evolved from a mainly agrarian society and became one of the world's three top manufacturers of a large number of capital goods, heavy industrial products and weaponry. However,

the USSR lagged far behind in the output of light industrial goods and consumer durables, mostly because of inability of Gosplan to predict the demand for such products. Since the dissolution of the Soviet Union in 1991, all 15 former Soviet republics have dismantled their Soviet-style economies.

8.1.2 Planning

Based on a system of state ownership, the Soviet economy was managed through Gosplan (the State Planning Commission), Gosbank (the State Bank) and the Gossnab (State Commission for Materials and Equipment Supply). Beginning in 1928, the economy was directed by a series of five year plans, with a brief attempt at seven-year planning. For every enterprise, planning ministries defined the mix of economic inputs (e.g., labor and raw materials), a schedule for completion, all wholesale prices and almost all retail prices. Industry was long concentrated after 1928 on the production of metallurgy, machine manufacture, and chemical industry. Soviet planners had very little reliable feedback which they could use to determine the success of their plans. This meant that economic planning was often done based on faulty or outdated information, particularly in sectors with large numbers of consumers. As a result of the above, some goods tended to be under produced, leading to shortages, while other goods were overproduced and accumulated in storage.

Heavy industry was always the focus of the Soviet economy, even in its later years. The fact that it received special attention from the planners, combined with the fact that industrial production was relatively easy to plan even without minute feedback, led to significant growth in that sector. The Soviet Union became one of the leading industrial nations of the world. Industrial production was disproportionately high in the Soviet Union compared to Western economies. However, the production of consumer goods was disproportionately low. Economic planners made little effort to determine the wishes of household consumers, resulting in severe shortages of many consumer goods. Whenever these consumer goods would become available on the market, consumers routinely had to stand in long lines (queues) to buy them. A black market developed for goods that were particularly sought after but constantly under produced (such as cigarettes).

Under Stalin's tutelage, a complex system of planning arrangements had developed since the introduction of the first five-year plan in 1928. Until the late-1980s and early-1990s, when economic reforms backed by Soviet leader Mikhail Gorbachev introduced significant changes in the traditional system, the allocation of resources was directed by a planning apparatus rather than through the interplay of market forces.

8.1.3 Economic Development

Starting in 1928, the five-year plans began building a heavy industrial base at once in an underdeveloped economy without waiting years for capital to accumulate through the expansion of light industry, and without reliance on external financing. The country now became industrialised at a hitherto unprecedented pace, surpassing Germany's pace of industrialisation in the 19th century and Japan's earlier in the 20th century.

1930-1970: As weighted growth rates, economic planning performed very well during the early and mid-1930s, World War-II era mobilisation, and for the first two decades of the postwar era. The Soviet Union became the world's leading producer of oil, coal, iron ore, and cement; manganese, gold, natural gas and other minerals were also of major importance. In 1961, new redenominated Soviet ruble was issued. It maintained exchange parity with the Pound Sterling until the dissolution of the USSR in 1991. By 1970, the Soviet economy had reached its zenith and was estimated at about 60 per cent of the size of the USA.

1970-1990: Growth in output and productivity slowed sharply after 1970. However, the planning ministries had failed to loosen their control of industrial production, storage and distribution in time to stem the prolonged stagnation of the 1970s and 1980s, which showed signs of a chronic problem. By 1990, the Soviet economy had plunged into its nadir and was estimated at about 20 per cent of the size of the USA.

The Soviet planned economy was not tailored at a sufficient pace to the demands of the more complex modern economy it had helped to forge. As the economy grew, the volume of decisions facing planners in Moscow became overwhelming. The cumbersome procedures for bureaucratic administration did not enable the free communication and flexible response required at the enterprise level for dealing with worker alienation, innovation, customers, and suppliers. During 1975-85, corruption and data fiddling became common practices among bureaucracy to report satisfied targets and quotas, thus entrenching the crisis.

Calls for greater freedom for managers to deal directly with suppliers and customers were gaining influence among reform-minded Communist cadres during the mid-1970s and 1980s were largely ignored. Economic growth was at a standstill after years of Soviet military buildup at the expense of domestic development.

1990-Present: Crisis in Gross Domestic Product developed in the former Soviet republics, now in the region of Caucasia: Armenia, Georgia. Following the dissolution of the Soviet Union, all of the former Soviet republics scrapped their Soviet-era systems of centralised planning and state ownership, to varying degrees, with mixed results.

8.1.4 Agriculture

Agriculture was organised into a system of collective farms and state farms. Organised on a large scale and highly mechanised, the Soviet Union was one of the world's leading producers of cereals, although bad harvests (as in 1972 and 1975) necessitated imports and slowed the economy. The 1976-1980 five-year plan shifted resources to agriculture, and 1978 saw a record harvest followed by another drop in overall production in 1979 and 1980 back to levels attained in 1975.

However, despite immense land resources, extensive machinery and chemical industries, and a large rural work force, Soviet agriculture was relatively unproductive, hampered in many areas by the climate (only 10.0% of the Soviet Union's land was arable), and poor worker productivity since the collectivisation in the 1930s. Lack of transport infrastructure also caused much waste.

8.1.5 Foreign Trade and Currency

Largely self-sufficient, the Soviet Union traded little in comparison to its economic strength. However, trade with non-communist countries increased in the 1970s as the government sought to compensate gaps in domestic production with imports.

In general, fuels, metals, and timber were exported. Machinery, consumer goods, and sometimes grain were imported. In the 1980s trade with the Council for Mutual Economic Assistance (COMECON) member states accounted for about half the country's volume of trade. Although often associated with alcohol production, such as that of vodka, none of these were leading Soviet exports.

Overall, the banking system was highly centralised and fully controlled by a single state-owned Gosbank, responsive to the fulfillment of the government's economic plans. Soviet banks furnished short-term credit to state-owned enterprises.

8.1.6 Forms of Property

There were two basic forms of property in the Soviet Union: individual property and collective property. These differed greatly in their content and legal status. According to communist theory, capital (means of production) could not be individually owned, with certain negligible exceptions. In particular, after the end of a short period of the New Economic Policy and with collectivisation completed, all industrial property and virtually all land were collective.

Land in rural areas was allotted for housing and some sustenance farming, and persons had certain rights to it, but it was not their property in full. In particular, in kolkhozes and sovkhozes there was a practice to rotate individual farming lots with collective lots. This resulted in situations where people would ameliorate, till and cultivate their lots carefully, adapting them to small-scale farming, and in 5-7 years those lots would be swapped for kolkhoz ones, typically with exhausted soil due to intensive, large-scale agriculture.

8.1.7 Socialistic Features of the Economy of Union of Soviet Socialist Republics

The Soviet Union aimed for a fully centrally planned economy. They dispensed almost entirely with private ownership of capital. Workers were still, however, effectively paid a wage for their labour. Some believe that according to Marxist theory this should have been a step towards a genuine workers' state. However, some Marxists consider this a misunderstanding of Marx's views of historical materialism, and his views of the process of socialisation. The characteristics of this model of economy were:

Production Quotas for every Productive Unit

A farm, mine or factory was judged on the basis of whether its production met the quota. It would be provided with a quota of the inputs it needed to start production, and then its quota of output would be taken away and given to downstream production units or distributed to consumers. Critics of both left and right persuasions have argued that the economy was plagued by incentive-related problems. To ensure allocative efficiency central planners would have required accurate information about the productive capabilities of each enterprise (including labour), however the system incentives enterprise managers to underreport their unit's productive capacities so that their quotas would be easier to achieve, especially since the manager's bonuses were linked to the fulfillment of quotas.

Allocation through Political Control

In contrast with systems where prices determined allocation of resources, in the Soviet Union, allocation, particularly of means of production was determined by bureaucratic elite, which was notable for its exclusion of democratic process. The prices that were constructed were done so after the formulation of the economy plan, and such prices did not factor into choices about what was produced and how it was produced in the first place.

Full Employment

Every worker was ensured employment. However workers were generally not directed to jobs. The central planning administration adjusted relative wages rates to influence job choice in accordance with the outlines of the current plan.

Clearing Goods by Planning

If a surplus of a product was accumulated, then the central planning authority would either reduce the quota for its production or increase the quota for its use.

Soviet history provides evidence that an economic system based on public ownership and economic planning can work effectively for many years. That type of system has brought economic progress in other countries as well, including China, Cuba, and the Eastern European countries. In the Soviet Union those industries that had politically powerful consumers produced high quality products that met the needs of those consumers. That applied to such industries as weapons, aerospace, metal processing, and several types of industrial machinery. If ordinary Soviet households had been politically empowered through a system of representation in the planning apparatus, it is not clear why the Soviet planned economy could not have delivered high quality consumer goods.

Check Your Progress 1

- 1) What are the characteristics of Soviet Union economy?

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8.2 SOCIALISTIC APPROACH: EXPERIENCE OF PEOPLES REPUBLIC OF CHINA

8.2.1 Introduction

China is the fourth largest economy in the world after the United States, Japan, and Germany with a nominal GDP of US\$ 3.251 trillion (2007) when measured in exchange rate terms. It has the world's second largest economy with a GDP of over \$ 7.1 trillion (2007) when measured on a purchasing power parity (PPP) basis. China is the fastest growing major economy in the world contributing the most to global growth in 2007. China's per capita income has grown at an average annual rate of more than 8% over the last three decades, drastically reducing poverty, but this rapid growth has been accompanied by rising income inequalities.

8.2.2 Growth of Chinese Economy over the Years

From 1949-1980:

In 1949, China followed a socialist heavy industry development strategy, or the "Big Push" strategy. Consumption was reduced while rapid industrialisation was given high priority. The government took control of a large part of the economy and redirected resources into building new factories. Entirely new industries were created. Most importantly, economic growth was jump-started. Tight control of budget and money supply reduced inflation by the end of 1950.

Throughout the 1950s and 1960s a number of widespread changes occurred in China's economic policies and procedures. During the first policy plan fast growth in heavy industry was achieved, but a few months after the introduction of the Second Five Year Plan (1958-1962), which was to be on the same lines as the First, the policy of the Great Leap Forward was announced. In agriculture, this involved the formation of people's communes, the abolition of private plots, and the increasing of output through greater cooperation and physical effort. Construction of large factories was to be continued apace, and in addition to that was there the initiative to create a massive auxiliary network of simple, small-scale industries and plants that were built and managed locally.

This policy, which led to an immediate improvement in the agricultural situation, was maintained until 1963, when it again became possible to redirect some resources to the capital goods industry. Then, in 1966 the "Great Proletarian Cultural Revolution" began, initially as a campaign for Mao to retake power from Liu Shaoqi and to "eliminate the liberal bourgeoisie" from the Party. Unlike the Great Leap Forward, the Cultural Revolution did not have an explicit economic rationale.

From 1980-1990

Since 1979, China began to make major reforms to its economy. The Chinese leadership adopted a pragmatic perspective on many political and socioeconomic problems, and sharply reduced the role of ideology in economic policy. Political and social stability, economic productivity, and public and consumer welfare were considered paramount and indivisible. In these years, the government emphasised raising personal income and consumption and introducing new management systems to help increase productivity. In the 1980s, China tried to combine central planning with market oriented reforms to increase productivity, living standards, and technological quality without exacerbating inflation, unemployment, and budget deficits. Reforms began in the agricultural, industrial, fiscal, financial, banking, price setting, and labor systems.

Rural and agricultural reforms began with major price increases for agricultural products in 1979. In 1981 the authorities began to dismantle the collectively farmed land, and it was with the introduction of the household responsibility system that these fields were contracted out to private families to work, which provided peasants greater decision-making in agricultural activities.

China's people's communes were largely eliminated by 1984 after more than 25 years in existence. Also by that time, much longer-term contracts for land were encouraged (generally 15 years or more), and the concentration of land through subleasing of parcels was made legal. In 1985 the government announced that it would dismantle the system of planned procurements with state-allocated production quotas in agriculture.

Several measures were taken to improve the incentives for enterprise managers so as to increase the efficiency of their firms. Enterprises were allowed to keep a substantial share of increases in production, so managers could be rewarded. During the 1980s, these reforms led to average annual rates of growth of 10% in agricultural and industrial output. The variety of light industrial and consumer goods increased.

A decision was made in 1978 to permit foreign direct investment in several small "special economic zones" along the coast. The country lacked the legal infrastructure and knowledge of international practices to make this prospect attractive for many foreign businesses, however. In the early 1980s steps were taken to expand the number of areas that could accept foreign investment with a minimum of red tape, and related efforts were made to develop the legal and other infrastructures necessary to make this work well.

By the late 1980s, the economy became overheated with increasing rates of inflation. At the end of 1988, in reaction to a surge of inflation caused by accelerated price reforms, the leadership introduced an austerity program. That same year, the 22 point regulation was also set by the PRC to encourage Taiwanese investments on mainland soil.

From 1990-2000

China's economy regained momentum in the early 1990s. During a Chinese New Year visit to Southern China in early 1992, China's paramount leader at the time Deng Xiaoping made a series of political pronouncements designed to give new impetus to and reinvigorate the process of economic reform. The 14th National

Communist Party Congress later in the year backed up Deng's renewed push for market reforms, stating that China's key task in the 1990s was to create a "socialist market economy". Continuity in the political system but bolder reforms in the economic system was announced as the hallmarks of the 10-year development plan for the 1990s.

During 1993, output and prices were accelerating, investment outside the state budget was soaring, and economic expansion was fueled by the introduction of more than 2,000 special economic zones (SEZs) and the influx of foreign capital that the SEZs facilitated. The government approved additional long-term reforms aimed at giving still more play to market-oriented institutions and at strengthening central control over the financial system; state enterprises would continue to dominate many key industries in what was now termed a "socialist market economy".

In 1996, the Chinese economy continued to grow at a rapid pace, at about 9.5%, accompanied by low inflation. In 1999, with its 1.25 billion people but a GDP of just \$3,800 per capita (PPP), China became the second largest economy in the world after the US.

From 2000-present

Following the Chinese Communist Party's Third Plenum, held in October 2003, Chinese legislators unveiled several proposed amendments to the state constitution. One of the most significant was a proposal to provide protection for private property rights. China's economy grew at an average rate of 10% per year during the period 1990-2004, the highest growth rate in the world.

Social and economic indicators have improved since reforms were launched, but rising inequality is evident between the more highly developed coastal provinces and the less developed, poorer inland regions. According to World Bank estimates in 2007, around 300 million people in China – mostly in rural areas of the lagging inland provinces – still lived in poverty, on consumption of less than \$1 a day.

8.2.3 Role of Government in Chinese Economy

Since 1949, the government, under China's socialist political and economic system, has been responsible for planning and managing national economy. In the early 1950s, the foreign trade system was monopolised by the state. Nearly all the domestic enterprises were state-owned and the government had set the prices for key commodities, controlled the level and general distribution of investment funds, determined output targets for major enterprises and branches, allocated energy resources, set wage levels and employment targets, operated the wholesale and retail networks, and steered the financial policy and banking system. In the countryside from the mid-1950s, the government established cropping patterns, set the level of prices, and fixed output targets for all major crops.

Since 1978 when economic reforms were instituted, the government role in the economy has lessened to a great degree. Industrial output by state enterprises slowly declined, although a few strategic industries, such as the aerospace industry have today remained predominantly state-owned. While the role of the government in managing the economy has been reduced and the role of both private enterprises and market forces increased, the government maintains a major role in the urban economy.

Each significant economic sector is supervised and controlled by one or more of these organisations, which includes the People's Bank of China, National Development and Reform Commission, Ministry of Finance, and the ministries of agriculture; coal industry; commerce; communications; education; light industry; metallurgical industry; petroleum industry; railways; textile industry; and water

resources and electric power. Several aspects of the economy are administered by specialised departments under the State Council, including the National Bureau of Statistics, Civil Aviation Administration of China, and the tourism bureau. Each of the economic organisations under the State Council directs the units under its jurisdiction through subordinate offices at the provincial and local levels.

The whole policy-making process involves extensive consultation and negotiation. Economic policies and decisions adopted by the National People's Congress and the State Council are to be passed on to the economic organisations under the State Council, which incorporates them into the plans for the various sectors of the economy. Economic plans and policies are implemented by a variety of direct and indirect control mechanisms. Direct control is exercised by designating specific physical output quotas and supply allocations for some goods and services. Indirect instruments – also called “economic levers” – operate by affecting market incentives. These included levying taxes, setting prices for products and supplies, allocating investment funds, monitoring and controlling financial transactions by the banking system, and controlling the allocation of key resources, such as skilled labor, electric power, transportation, steel, and chemicals (including fertilizers).

Total economic enterprise in China is apportioned along lines of directive planning (mandatory), indicative planning (indirect implementation of central directives), and those left to market forces. In the early 1980s during the initial reforms enterprises began to have increasing discretion over the quantities of inputs purchased, the sources of inputs, the variety of products manufactured, and the production process. Operational supervision over economic projects has devolved primarily to provincial, municipal, and country governments.

The majority of state-owned industrial enterprises, which were managed at the provincial level or below, were partially regulated by a combination of specific allocations and indirect controls, but they also produced goods outside the plan for sale in the market. Important, scarce resources – for example, engineers or finished steel may have been assigned to this kind of unit in exact numbers. Less critical assignments of personnel and materials would have been authorised in a general way by the plan, but with procurement arrangements left up to the enterprise management.

Consumer spending has been subject to a limited degree of direct government influence but is primarily determined by the basic market forces of income levels and commodity prices. Before the reform period, key goods were rationed when they were in short supply, but by the mid-1980s availability had increased to the point that rationing was discontinued for everything except grain, which could also be purchased in the free markets. Foreign trade is supervised by the Ministry of Commerce, customs, and the Bank of China, the foreign exchange arm of the Chinese banking system, which controls access to the foreign currency required for imports.

Through the 1990s China was widely and often held up as a paragon of economic policy reform driven growth and an example for others to follow. China has also gone out of the way to make economic interaction with it (e.g. FDI, outsourcing of manufacturing) profitable for foreigners (non-Chinese), so their interests are best served by publicising information that ensures that profitable interaction with the Chinese Communist Party (CCP) and the State continue.

8.3.4 Market Element in China

In China, the ‘market’ element has expanded gradually since the start of the agricultural reforms in 1971 and the introduction of urban reforms in 1984. In 1992 China publicly stated that its goal is a “socialist market economy with Chinese Characteristics”. Though China has successfully expanded the scope of the market,

“socialist” (communist) control of factors remains very important. An understanding of these elements is essential to an understanding of the economic performance of China.

The primary “market” economy is in products (goods & non-infrastructure services) where even CCP controlled enterprises compete to maximise growth, as in a private corporate economy. The other market elements are external capital (100% foreign invested enterprises and Joint Ventures) and external trade. Exports and FDI have played such an important role in China’s economy that its growth has been characterised as ‘Export-led growth,’ and could since 1990 be characterised as ‘FDI-export led growth’. The extent to which import trade is now free is not entirely clear, though on balance this could be put into the market category. There is also a competitive fringe of individual capitalists/private capital that operates in export production.

The socialist planning system still operates, however, in factor markets (land, labour, capital) and infrastructure and the pricing of these inputs is used to provide (indirect) subsidies to foreign investors and domestic exporters. Cities/Provinces can and do price land to any buyer at any price. The labour responsibility system determines where person can work legally and where it cannot. The banking system has evolved little from a government department where loans are decided on the basis of provincial/national objectives and ability to repay is irrelevant (variable cost of capital).

Infrastructure pricing and supply (particularly to foreign invested enterprises) is similarly decided on the basis of national/ provincial/ city objectives and can vary with enterprise. This is also true to some extent for the output of the State Owned Enterprises (SOEs) which remain subject to central department (their bosses) orders and directions.

In moving from the “Socialist” to the “Socialist Market” Economy, China has borrowed aspects from the “Nationalist Market Economies” of developing Japan, South Korea and Singapore. The primary objective of the latter governments was to catch-up with the advanced countries through fast growth of average income. They therefore developed a national consensus to maximise GDP growth. The whole nation was mobilised to achieve this goal. The simplicity of this objective (growth, investment, production) made it much easier to decentralised it and ensure accountability at every level including that of the private corporate sector.

8.3.5 Socialist Elements in China

1. Leninist Party

The standard Marxist-Leninist description of the Communist ruled State is the “Dictatorship of the Proletariat”. In China as in other communist/socialist states this means the dictatorship of the Chinese Communist Party (CCP). The party is a hierarchy stretching from the party general secretary at the top to the party honcho in the smallest settlement/village. The objectives, broad approach to achievement of these objectives and the parameters within which lower levels can take initiatives, are decided at the top. Within this framework there is a multilevel decision making process from the national to provincial, metro cities and Town & Village level.

2. Decentralisation of Socialist Production

This decentralisation is not a post-1978 development but has evolved since the 1960s, with the decentralisation of planning authority first to the provinces and then to the county. Studies shows that local governments in addition to having gained greater autonomy over allocation of materials from the Center during the Cultural Revolution, were also to a large extent able to bypass the material

allocations of the central plans by setting up local enterprises with local funds. The level of Central government control fluctuated from then onwards, but decreased during the Cultural Revolution. Some materials which had been under direct allocation by the State Planning Commission or by the Central ministries were now allowed to be locally allocated.

3. Post-1980 Financial Incentives

The degree of operational freedom and flexibility within the designed and designated sphere of operation of the lower levels has however, increased since 1980. The most important impact of the post-Mao period reforms was to increase the financial incentives of the local governments to promote investment in their regions – as not only the means to hedge against shortages under planned quotas, but as a means to increase local revenue (and hence the bonuses and perks they could award themselves), local employment and incomes (including those of their family and friends, through control over local enterprises). China's governance system is therefore a mix of centralised and decentralised elements, bearing little resemblance to Stalinist USSR.

4. Factor Markets

The socialist control over factor markets is pervasive, compared to any 'democratic market economy,' though it may appear liberal relative to the former USSR or Mao's China. This includes the Land, Labour and Capital Markets.

- a) **Land:** All land is owned and controlled by the State. Because of the historical legacy of cooperative ownership of farmland, the system is slightly different in the rural areas. In many provinces farming households ostensibly have an ownership share in village and farm land, but lose this right if they move to the urban areas to work.
- b) **Labour:** In every Communist country the party controlled the labour unions and therefore the terms and conditions of work. This is also true in China and therefore the overall policy approach to terms & conditions of employment, work hours and wages is decided by the CCP (at an appropriate geographical level or level of government). If the CCP decides to apply different work and pay rules in a particular province, sector, industry or type of enterprise (e.g. foreign invested) from those applied to general domestic enterprises, neither the (so called) labour unions nor the employees can do anything about it. They can either like it or lump it.
- c) **Capital:** In 1980, 100 per cent of capital assets were owned and controlled by the State/CCP. The management of these assets was distributed to different levels of government, which in turn was (is) controlled by different levels of the party. Some were controlled at the National level through the departments of the central government and their CCP bosses. Others are managed/ controlled at the provincial, City and Village level (village co-operatives, Town and Villages enterprises).

5. Market Elements

- a) **Product market:** The most important market innovation that China introduced into its socialist economy was the product market. In 1979 it started with agriculture output markets. Initially agriculture markets were partially liberalised in a manner similar to that used in India for sugar and other markets in the sixties. This was a 'Dual pricing and distribution' system in which part of the produce continued to be handed over to the government at a controlled price, while the rest could be sold freely at the market price.

- b) **International markets:** In the early years external trade was carried out largely by State trading companies and Provincial trading companies and by 1993 there were 4000 such government controlled foreign trade companies. External trade can now be taken as largely market based even though the system retains a strong bias against imports; though policy biases against imports by domestic firms have been gradually removed government and managers have an asymmetric attitude to exports and imports.
- c) **Exchange rate:** In early 1980s foreign exchange was tightly controlled by the Bank of China even for foreign investors who needed to repatriate profit or import inputs for export. To attract export oriented FDI from Hong Kong and other overseas Chinese, government created 'foreign exchange adjustment centers' or swap markets on which those with surplus foreign exchange (e.g. joint venture hotels) could sell their surplus foreign exchange to foreign firms at market determined rates. The establishment of these centers effectively freed imports for FDI producers.

6. Growth Model

China is a nationalist State with a clear vision of national power through economic growth and technological catch-up. The Chinese Communist party translates his vision into explicit objectives suitable for different levels (nation, province, and city, firm) that are broadly coherent but far from perfect (not devoid of contradictions).

Among the sub-goals that this translates into are increased sales/production, value added, investment and technology transfer from the advanced countries. The growth strategy for achieving these objectives has evolved over time. Starting from the mid-1970s it first became an export-led growth strategy and then from the mid-1980s and FDI-export led growth strategy. Underlying these has been the development of domestic product markets and the evolution of the management structures of government enterprises to meet the challenges of competition in domestic and global markets.

Check Your Progress 2

- 1) What are economic characteristics of China?

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8.3 SOCIALISTIC APPROACH: EXPERIENCES OF EASTERN EUROPE

The United Nations Statistics Division considers Eastern Europe to consist of the following ten countries Belarus, Bulgaria, Czech Republic, Hungary, Moldova, Poland, Romania, Russia, Slovakia, and Ukraine.

In late 1989 the countries of Eastern Europe broke loose from the Soviet Union, threw off communism, and began to construct democratic institutions and market-oriented economies. This great transformation is founded on the idea that freedom and prosperity can best be advanced by adopting the institutions and practices that have proven successful in Western Europe since World War II. The people of the

region want "to return to Europe". To do so, they plan to dismantle the remnants of the communist economic system and build market-oriented economies based on private ownership.

Some countries in Eastern Europe sought to stave off collapse by replacing central planning with decentralised decision making. These communist-led reforms brought some improvement but did not lead to the emergence of normal competitive market relations. In the end each country in the region suffered an economic collapse and a cessation of sustained growth, and in some cases, acute shortages, balance of payments crises, and financial chaos.

The genesis of the financial crises came from deep within the system. Subsidies ballooned as governments tried to keep the prices of many consumer products and services low for households and tried to keep profits high in state enterprises (where managers were too willing to grant excessive wage increases). Credits to enterprises also ballooned in support of the huge appetite for investments on the part of state enterprises (where managers craved investment projects that might add to their power and prestige).

Subsidies and credits were paid by printing money, which led to a steady buildup of demand throughout these economies. The ballooning of demand created shortages wherever price controls were inflexible, inflation wherever prices were allowed to rise, and external debt and balance of payments crises in most countries. The buildup of demand in Poland, for example, can be seen clearly in the gap between the black market exchange rate and the official one, which rose from 250% in early 1988 to 500% in mid-1989.

The collapse of living standards was broadly felt across Eastern Europe. Industrial production did not slow appreciably because strenuous efforts were made to channel the available resources to heavy industry. The result of this strategy was a decline in living standards for the population. While there were substantial differences among countries in the region, the people of Eastern Europe found goods increasingly unavailable at official prices, longer queues and bigger shortages, an absence of imported consumer goods, and in some cases, deterioration in public services and basic utilities such as heat and hot water.

As the new governments of Eastern Europe surveyed the ruins of the communist system and prepared to transform their economies, they were initially preoccupied with the question of whether to free prices from centralised control quickly in order to cope with the shortages, high inflation, and scarcity of dollars. Alternatively, they could first reform the laws, institutions, and ownership structure to allow private property. Freeing prices from centralised control in the absence of private property seemed risky to many, because state enterprises would be granted too much market power and would operate in an unruly and unregulated environment.

Most governments concluded that reform was a seamless web, such that liberalisation and structural reforms must be woven together simultaneously. The pattern of the web, however, varied from country to country. In some the financial collapse was so acute that there was no room for maneuver. The Solidarity government in Poland, for example, inherited a hyperinflation so debilitating that immediate steps were necessary. But Czechoslovakia, where the financial situation was not as acute and the communist-led reform was limited, spent one year attempting to prepare the way for marketisation.

The political system dominating Eastern and Central Europe in the inter-war period was unable to resolve economic problems in this region, because the industrial development had largely derived from foreign investment. After the war, in all Eastern European countries, reconstruction plans were adopted; these at the beginning were different from the Soviet-model (except in the case of Yugoslavia),

and they were closer to a radical system of state intervention and control. The final goal was that of solving the post-war crisis (severe shortages of food, energy, raw materials, transportation, reconstruction of infrastructures, war reparations).

Stabilisation efforts in Eastern Europe have aimed at creating a stable financial environment that will foster the rapid growth of domestic business activity, international trade, and foreign direct investment. By reducing budget deficits, slowing the growth of the money supply, and establishing realistic exchange rates, Czechoslovakia, Hungary, and Poland have ended the chronic shortages that have plagued their economies and have achieved low rates of inflation and relatively stable exchange rates.

Economic liberalisation includes permitting households and enterprises to conduct business freely, buying and selling at prices set by supply and demand. This has meant, among other things, a sweeping elimination of government price controls. In most countries liberalisation has also been backed by changes in the legal framework aimed at allowing private gain, and deregulation to limit government interference in economic activities.

The new governments also understand that the success of liberalisation requires the protection of private property and the freedom to start private businesses. These freedoms are needed to foster a new private sector that strengthens competitive forces and channels resources into productive capital investments.

Because the countries of Eastern Europe are small and situated near the great market of the European Economic Community, another important component of liberalisation has been the opening up of international trade. In the short run the opportunity to trade with the West has provided instant competition, greatly diminishing the domestic monopoly power of monolithic state enterprises. In the long run, international trade holds the key to the eventual integration of the economies of Eastern Europe with the economies of the West.

The Eastern European economies are responding strongly to the opening up of international trade. Most countries in the region have increased exports, which will increase economic integration with the West. In Poland, for example, exports to the West rose from \$8.5 billion in 1989 to about \$13 billion in 1991, a period in which Poland's GDP was falling. Poland's ability to market its goods abroad has moderated the decline in living standards. The growth in Eastern European exports is vital to the modernisation of the region because it provides the finance for needed imports of capital and technologies.

Liberalisation of economic activity has also sparked the growth of private sector activity. The emergence of a new private sector has perhaps been greatest in Poland, where hundreds of thousands of new small businesses were opened in 1990, but Hungary and Czechoslovakia are not far behind. In Warsaw roughly 90% of retail shops are now in private hands. The service sector, long suppressed under the communist system, is mushrooming, and new private manufacturing activity is beginning, though still on a modest scale.

Privatisation is widely regarded by the new governments of Eastern Europe as a necessary step to making the best economic use of state property. It is well understood that much of the capital stock inherited from the past is dilapidated, based on outmoded technologies, and aimed at the now-collapsed Soviet market. The decisions of what to shut down, what to restructure, and what to modernise are best made by private owners with a true stake in the economic future of the firm.

The privatisation challenge is enormous. The countries of Eastern Europe must privatise a wide range of property, including trucks, housing, shops, foreign trading firms, commercial banks, small manufacturing operations, and huge industrial

concerns. Most countries have quickly privatised physical property and small shops. Auctions, leases, and other techniques have put a large proportion of retail trade and small service establishments in private hands in several countries. Because large industrial enterprises are more difficult to privatise, they are being privatised slowly.

Several countries initially flirted with the notion of adopting Western privatization techniques such as public offerings of enterprise stock – for selling large industrial enterprises. These techniques have been too slow and too expensive. Margaret Thatcher's government privatised about two dozen firms in a decade; the countries of Eastern Europe have thousands of industrial enterprises to privatise.

The State became the most important buyer in the market (in Hungary 75% of the industrial firms income was originated by State orders in 1946-47). The useful State intervention was used by Communist parties to improve their influence and to get closer to the Sovietisation. They dealt with the end of old social hierarchy and the dominance of the Church, with the control of large monopolies, the first nationalisation and the land reforms. In fact, when the Soviet model was implemented in most of the countries, the nationalisation was already done.

The middle of the twentieth century also marked the onset of industrialisation and profound structural change in the countries of interest to us. Now, with the benefit of hindsight, we can see that the first three postwar decades were a period of unprecedented growth. The Eastern European countries were the first to take off, and they experienced rapid economic growth until the 1970s, when the constraints of the socialist model became manifest.

In Eastern Europe, all Communist governments initiated centrally planned industrialisation drives immediately after the consolidation of Communist power in the late 1940s. This strategy rested on high levels of investment in basic industry, the mobilisation of labor, and a squeeze on the countryside. The commitment to full employment and government provision of social insurance and services emerged as side effects of the complete socialisation of the economy.

In the absence of any private sector, the government was perforce involved in both the financing and provision of health care, pensions, and even housing. Even though these entitlements originated in the state-owned enterprise sector, the collectivisation of agriculture extended them into the countryside and provided the basis for the universalisation of benefits. Similarly, government interest in the expansion of education, and its particular emphasis on vocational training, was a direct complement of the socialist system of manpower planning.

In these countries, Planned Economy, not unknown before the war, was based on a great number of indicators, from investments to production (of materials, manpower, energy, products, quality, quantity, cost of production etc), that each company had to follow; it also replaced market prices with fixed prices controlled by central authorities, with the obvious consequence that prices did not reflect real value of production. There were no compulsory indicators in foreign trade since it was connected with other countries, so to counterbalance these not planned elements, foreign trade prices were isolated from domestic prices.

It was the State's price fund to level the differences: for the exports, producing companies gave their products to foreign trade companies at the domestic price and the latter sold the products at a lower or higher price. The same happened with the imports that were sold at the producer's price to domestic companies and delivered at the domestic price. The goal was to deal with problems in a centralised way in order to minimise "accidental" elements and to increase the national industrial outputs, forcing industrialisation.

Check Your Progress 3

- 1) What are the socialistic approach experiences in the Eastern Europe?

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8.4 LET US SUM UP

In this unit we have discussed the experience of socialistic approach to economic development in Soviet Union, Peoples Republic of China, and Eastern Europe. We have seen economic history of Soviet Union, their historical experiences and also the socialistic features of Soviet Union, Peoples Republic of China, and Eastern Europe. Further, the working of the economy of Soviet Union, Peoples Republic of China, and Eastern Europe with socialistic approach is also discussed.

8.5 KEY WORDS

Socialist economy : Economy administered on socialistic principles.

Economic history of Soviet Union : Economic development of Soviet Union.

Economic history of China : Economic development of Chain.

8.6 SOME USEFUL BOOKS

- 1) Agarwal B L (1989): "*Alternative Economic Structures*", Allied Publishers New Delhi.
- 2) R.W Davies, Mark Harrison, and S.G Wheatcroft (Eds.) (1994): *The Economic Transition of Soviet Union, 1913-1945* Cambridge University Press.
- 3) Joseph C Brada, E.A Hewett, and Thomas A Wolf (1988): "*Economic Adjustment and Reform in Eastern Europe and the Soviet Union*", Duke University Press.

8.7 ANSWER OR HINTS TO CHECK YOUR PROGRESS

Check Your Progress 1

- 1) Based on a system of state ownership, the Soviet economy was managed through Gosplan (the State Planning Commission), Gosbank (the State Bank) and the Gossnab (State Commission for Materials and Equipment Supply). Agriculture was organised into a system of collective farms and state farms. Largely self-sufficient, the Soviet Union traded little in comparison to its economic strength. There were two basic forms of property in the Soviet Union: individual property and collective property.

Check Your Progress 2

- 1) China is the fourth largest economy in the world. Since 1949, the government, under China's socialist political and economic system, has been responsible for planning and managing national economy. The whole policy-making process involves extensive consultation and negotiation. In China, the 'market' element has expanded gradually since the start of the agricultural reforms in 1971 and the introduction of urban reforms in 1984.

Check Your Progress 3

- 1) Eastern Europe broke loose from the Soviet Union, threw off communism, and began to construct democratic institutions and market-oriented economies. This great transformation is founded on the idea that freedom and prosperity can best be advanced by adopting the institutions and practices that have proven successful in Western Europe since World War II.

The people of the region want "to return to Europe". To do so, they plan to dismantle the remnants of the communist economic system and build market-oriented economies based on private ownership. Some countries in Eastern Europe sought to stave off collapse by replacing central planning with decentralised decision making. These communist-led reforms brought some improvement but did not lead to the emergence of normal competitive market relations. In the end each country in the region suffered an economic collapse and a cessation of sustained growth, and in some cases, acute shortages, balance of payments crises, and financial chaos.

8.8 EXERCISES

- 1) Explain the economic development experience of Soviet Union
- 2) Explain the economic development experience of Peoples Republic of China.
- 3) Explain the economic development experience of Eastern Europe.

UNIT 9 MARKET SOCIALISM: EXPERIENCE OF SCANDINAVIAN AND NORDIC COUNTRIES

Structure

- 9.0 Objectives
- 9.1 Introduction
- 9.2 Meaning of Market Socialism
- 9.3 Theoretical Evolution
 - 9.3.1 A Critique of Lange's Market Socialist Model
- 9.4 Theoretical Basis
- 9.5 Problems of Market Socialism
- 9.6 Market Socialism: Experience of Scandinavian Countries
- 9.7 Market Socialism: Experience of Nordic Countries
- 9.8 Let Us Sum Up
- 9.9 Key Words
- 9.10 Some Useful Books
- 9.11 Answer or Hints to Check Your Progress
- 9.12 Exercises

9.0 OBJECTIVES

After going through this unit, you will be able to:

- explain the meaning of Market Socialism;
- describe the theoretical history of market socialism;
- discuss the theoretical basis of market socialism; and
- analyse the experience of Scandinavian and Nordic Countries.

9.1 INTRODUCTION

In this unit we discuss about the market socialism. Discussions are provided on meaning of market socialism, their history and theoretical base, problems of these economies and also the experiences of Scandinavian and Nordic countries.

9.2 MEANING OF MARKET SOCIALISM

Market socialism is a term used to denote two different economic systems based in socialism which operate according to market principles. The first term relates to an economy directed and guided by socialist planners on either a local or state level, while the second refers to a system of free exchange with socialist organisations being predominant.

Market socialism is characterised primarily by the public ownership of the means of production. Decisions with reference to the allocation of resources are made both collectively and by individual producing and consuming units. Prices and markets are the primary mechanisms used to facilitate the exchange of products.

In this system, individual state owned enterprises compete in a market setting for sales and inputs. They are free to determine what to produce and how to produce it and are guided by prices. Prices may be set in the market place by the impersonal forces of supply and demand or by a central planning board in response to observed shortages and surpluses.

The primary distinction between market socialism and the competitive market economy is the ownership of the means of production. Under market socialism individual households own and can freely dispose of only their own labour or liquid savings. They may not accumulate wealth in the form of earning property.

The profits gained in production by firms will be distributed back to the members of the economy according to a state devised allocation scheme. The state may or may not play a significant role in the allocation of resources, but it has the residual power to influence resource allocation through its influence on prices through the central planning board and through its allocation of profits. The Yugoslav economy contains many of the elements of market socialism, although, as we shall see, it also is a unique blend of economic institutions.

Market socialism has also been used as a name for any attempt by a Soviet-style economy to introduce market elements into its economic system. In this sense, "market socialism" was first attempted during the 1920s in the Soviet Union as the New Economic Policy (NEP), but soon abandoned. Later, elements of "market socialism" were introduced in Hungary (where it was nicknamed "goulash communism"), Czechoslovakia and Yugoslavia in the 1970s and 1980s. Modern Vietnam and Laos also describe themselves as market socialist systems. The Soviet Union attempted to introduce a market socialist system with its perestroika reforms under Mikhail Gorbachev.

Historically, these kinds of "market socialist" systems attempt to retain government ownership of the commanding heights of the economy, such as heavy industry, energy, and infrastructure, while introducing decentralised decision making and giving local managers more freedom to make decisions and respond to market demands.

Market socialist systems also allow private ownership and entrepreneurship in the service and other secondary economic sectors. The market is allowed to determine prices for consumer goods and agricultural products, and farmers are allowed to sell all or some of their products on the open market and keep some or all of the profit as an incentive to increase and improve production.

The Chinese experience with socialism with Chinese characteristics is frequently referred to as a 'Socialist Market Economy' in which the 'commanding heights' remain in public ownership, but a substantial portion of the economy is governed by free market practices, including a stock exchange for trading equity.

The economic doctrine of market socialism holds that central planners can make active and efficient use of "the market" as a mechanism for implementing socially desired goals, which are developed and elaborated through central planning of economic activity.

Focusing on the elimination of private property and wealth, and on the central determination and control of all investment and development decisions, it posits that the planned determination and adjustment of producers' and asset prices could allow markets to implement the desired allocations in a decentralised manner

without sacrificing central or social control over outcomes or incomes. Thus egalitarian social outcomes and dynamic economic growth can be achieved simultaneously, without the disruptions and suffering imposed by poorly coordinated private investment decisions resulting in a wasteful business cycle.

The idea of market socialism arose from the realisation that classical socialism, involving the collective provision and distribution of goods and services in natural form, without the social contrivances of property, markets, and prices, was not feasible, since rational collective control of economic activity requires calculations that cannot rely consistently on "natural unit" variables such as energy or labour amounts.

It also became clear that the existing computing capabilities were inadequate for deriving a consistent economic plan from a general equilibrium problem. This led, in the Socialist Calculation Debate of the 1930s, to the suggestion (most notably by Oskar Lange) that a Socialist regime, assuming ownership of all means of production, could use markets to find relevant consumers' prices and valuations while maintaining social and state control over production, income determination, investment, and economic development. Managers would be instructed to minimise costs, while the planning board would adjust producers' prices to eliminate disequilibria in the markets for final goods.

Thus, at socialist market equilibrium, the classical marginal conditions of static efficiency would be maintained, while the State would ensure equitable distribution of incomes through its allocation of the surplus (profit) from efficient production and investment in socially desirable planned development.

Another version of market socialism arose as a result of the reform experiences in east-central Europe, particularly the labor-managed economic system of Yugoslavia that developed following Marshal Tito's break with Josef Stalin in 1950. This gave rise to a large body of literature on the "Illyrian Firm" with decentralised, democratic control of production by workers' collectives in a market economy subject to substantial macroeconomic planning and income redistribution through taxation and subsidies.

The economic reforms in Hungary (1968), Poland (1981), China after 1978, and Gorbachev's Russia (1987-1991) involved varying degrees of decentralisation of State Socialism and its administrative command economy, providing partial approximations to the classical market socialist model of Oskar Lange.

This experience highlighted the difficulties of planning for and controlling decentralised markets, and revealed the failure of market socialism to provide incentives for managers to follow the rules necessary for economic efficiency. Faced with these circumstances, proponents of market socialism moved beyond state ownership and control of property to various forms of economic democracy and collective property, accepting the necessity of real markets and market prices but maintaining the classical socialist rejection of fully private productive property.

9.3 THEORETICAL EVOLUTION

The earliest models of this form of market socialism were developed by Enrico Barone (1908) and Oskar R. Lange (1936). Lange and Fred M. Taylor proposed that central planning boards set prices through "trial and error", making adjustments as shortages and surpluses occurred rather than relying on a free price mechanism. If there were shortages, prices would be raised; if there were surpluses, prices would be lowered.

Raising the prices would encourage businesses to increase production, driven by their desire to increase their profits, and in doing so eliminate the shortage. Lowering the prices would encourage businesses to curtail production in order to prevent losses, which would eliminate the surplus. Therefore, it would be a simulation of the market mechanism, which Lange thought would be capable of effectively managing supply and demand.

A second form of market socialism is called by its proponents free market socialism because it does not involve planners. Pierre-Joseph Proudhon developed a theoretical system called mutualism, which attacks the legitimacy of existing property rights, subsidies, corporations, banking, and rent. Proudhon envisioned a decentralised market where people would enter the market with equal power; negating wage slavery. Proponents believe that cooperatives, credit unions, and other forms of worker ownership will become viable without being subject to the state. Market socialism has also been used to describe some individualist anarchist works which argue that free markets help workers and weaken capitalists.

HD Dickinson published two articles proposing a form of market socialism: *Price Formation in a Socialist Community* (The Economic Journal 1933) and *The Problems of a Socialist Economy* (The Economic Journal 1934). Dickinson proposed a mathematical solution whereby the problems of a socialist economy could be solved by a central planning agency.

The Lange-Dickinson version of market socialism kept capital investment out of the market. Lange (1926) insisted that a central planning board would have to set capital accumulation rates arbitrarily. Lange and Dickinson saw potential problems with bureaucratisation in market socialism. According to Dickinson “the attempt to check irresponsibility will tie up managers of socialist enterprises with so much red tape and bureaucratic regulation that they will lose all initiative and independence” (Dickinson 1938). In the *Economics of Control* (1944) Abba Lerner admitted that capital investment would be politicised in market socialism.

Although the name is similar, it differs from the socialist market economy which is practiced within the People’s Republic of China in its form of socialism with Chinese characteristics. Within a socialist market economy, much of industry is state owned, but prices are not set by a central planning board.

Proponents of market socialism argue that it combines the advantages of a market economy with those of socialist economics. Economist John Roemer (who developed ‘Coupon Socialism’) and philosopher David Schweickart, whose version of market socialism is called “Economic Democracy”, are two separate advocates of socialist market.

Bardham and Roemer suggested a form of Market Socialism where there was a ‘stock market’ that distributed capital fairly between the workers. In this stock market, there is no buying or selling of stocks, which leads to negative externalities associated with a concentration of capital ownership. The Bardham and Roemer model satisfied the main requirements of both Socialism (workers own all the factors of production – not just labour) and market economies (prices determine efficient allocation of resources).

A New Zealand Economist, Steven O’Donnell, expanded on the Bardham and Roemer model and decomposed the capital function in a general equilibrium system to take account of entrepreneurial activity in market socialist economies. O’Donnell (2003) set up a model that could be used as a blueprint for transition economies, and the results suggested that although market socialist models were inherently unstable in the long term, in the short term they would provide the economic infrastructure necessary for a successful transition from Socialist to market economy.

9.3.1 A Critique of Lange's Market Socialist Model

This market socialist model so faithfully reproduces the static efficiency conditions dear to the hearts of economists and so admirably achieved by competitive capitalism that one is tempted to ask, why bother switching from one system to another? The socialist would respond that capitalist profits and rents are too much compensation for the simple task of allocating resources efficiently. The state can do the job just as well using the devices just outlined above and at considerably lower resource cost. The difference may be invested for even greater growth potential or given out for all to enhance their present consumption. The class of individuals who otherwise would have made a substantial living from the use of their property can still live as well as their skills can earn in a free labour market.

A substantive criticism of the model should begin by granting that the system may indeed work as well in blueprint form as does competitive capitalism: but like capitalism, in practice there are all sorts of problems. First, motivating the firm manager to do the right thing may be tricky. Such men cannot be expected to be automatons; they will want and deserve rewards for success. But what will measure success? Equating marginal cost with price is a technical exercise, and it is rather difficult to establish whether or not you have accomplished it. If the reward is in proportion to the output of the firm, the manager may respond by reducing quality, as we have seen in the Soviet case. If the reward is in proportion to profits earned, then the manager is properly motivated but may choose to exercise any latent market power the firm may possess. Singly or collectively, firm managers in concentrated industries could cut back production. The Central Planning Board would observe the resulting shortage and raise the price of the product. The firm or firms would thus have achieved the same results as a capitalist monopoly or cartel arrangement.

Second, there are problems with the role of the Socialist Industry manager. In bureaucratic structures men are frequently rewarded materially and with prestige in proportion to the size of the establishment they manage. This may work to prevent the desired contraction of a declining industry as well as to prompt unnecessary expansion in progressive industries. Moreover, the industry manager may strike up a cozy relationship with the firms under his jurisdiction and restrict entry so as to assure the profitability of existing firms. Again, we observe results analogous to European cartels or some "regulated" industries in the United States.

Finally, the Central Planning Board (CPB) cannot really remain just an information collection agency. The number of prices it must manage will run into the hundreds of thousands, perhaps millions. The more prices the CPB must manage, the slower the inevitable price changes will come. The longer the time between price changes, the greater will be the shortages and surpluses resulting from dynamic shifts of supply and demand conditions. Firms will be under tremendous pressure to switch to products with the most recent or most favourable price change even though society may need their present product as much or more. Firms may also artificially differentiate their old products so as to get a quick new product CPB price ruling. Under these sorts of pressures the system of pricing can rapidly explode in complexity. The CPB can respond to complexity by ordering firms to produce a limited line of products to minimise the number of prices it has to manage. This line of development clearly violates the condition of consumer sovereignty and is evolving toward central planning.

9.4 THEORETICAL BASIS

The key theoretical basis for market socialism is the negation of the underlying expropriation of surplus value present in other, exploitative, modes of production.

An important base for the first definition of market socialism in economic theory is the Lange Model, which states that an economy in which all production is performed by the state, but in which there is a functioning price mechanism, has similar properties to a market economy under perfect competition, in that it achieves Pareto efficiency.

Socialist Economics or Socialist Theories are one of the most controversial theories for the economic development of a nation with the concomitant growth in social welfare. Originally perceived as an idea for the upliftment of the working class who seemed to be destined to be driven down to subsistence wages by the “capitalists” who owned capital and rented land, Socialist Economics has undergone many changes in the course of time.

Socialist economy is a structure of the economy which aims at providing greater equality and giving the “proletariat” or working class greater ownership over the means of production. In a normative sense, a socialist economy or a socialist state believes that socialism is the most equitable and socially serviceable form of an economic arrangement designed to achieve human potentialities.

Unlike “capitalism” where the means of production are owned by the capitalists, Socialist economies are characterised by the means of production owned by the state or by the workers collectively. Marx called socialism an intermediary stage between “capitalism” and the ultimate outcome of “communism”. The basic doctrine of Socialism of producing according to ones capacity and receiving according to ones want was replicated in the Soviet Union who became the first socialist state in 1917. It was followed later in certain eastern European countries and later moved to China under Mao Zedong.

While some western economies experimenting with socialism had adopted measures such as nationalisation, redistribution of wealth among the poor, minimum wage measures and policies of demand management along Keynesian lines, erstwhile USSR was a centrally planned economy. It functioned by the imposition of production quotas and the clearing of goods was done was by a central planning authority. Even prices for allocation of goods and services were predetermined by the state.

The socialist states were later deemed to be corrupt with government mandarins appropriating too much power and with excessive state controls, the state of “communism” or distributing power evenly among the population with decentralisation of power from the state never really occurred.

Some economic models within the framework of Socialism are:

- Public-enterprise centrally planned economy
- Public-enterprise state managed market economy
- Mixed economy
- Public enterprise employee managed market economies
- Public enterprise participatory planning

Of the models mentioned above, the public enterprise state managed market economy or a form of social market economy and the model of mixed economy are the most popular in contemporary times.

The “social market economy” or “market socialism” has the state owning the means of production but there is a market directed and guided by socialist planners. The market is given the free hand to allocate and distribute the country’s resources based on the forces of supply and demand. It thus retains the essential feature of

efficiency, growth and production of surplus value generally associated with capitalist economies.

This model was effectively launched in China after reform, Hungary, Yugoslavia and Czechoslovakia in the 1970's and 1980's and is presently adopted in Germany. Government ownership is retained in key sectors such as heavy industry, energy and infrastructure while private ownership or entrepreneurship with public-private participation is followed along the lines of the mixed economy model. India also follows a model of a mixed economy. The greatest asset of this sort of economy is the decentralisation of decision making and giving local managers more freedom to respond to market conditions. This also sometimes called a mild version of state socialism and are called social democracies where the socialists do not overthrow the capitalist system altogether but mould it to social purposes. Social market economy is here to stay and market socialism is only an improved form of traditional state socialism.

Check Your Progress 1

1) What do you mean by market socialism?

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2) Discuss Lange's Market Socialist model.

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9.5 PROBLEMS OF MARKET SOCIALISM

A system of independently managed government-owned enterprises maximising profits at market prices would run into some of the same problems that market capitalism would. Like market capitalism, the values it would realise would be consumer preferences, not other kinds of values that some may feel are "higher". Monopoly and externality could also be problems, and perhaps "Keynesian" failures to employ the labor force might occur. Thus, in practice it would be necessary for a market socialist society (like a market capitalist society) to mix in a good deal of government control of the economy.

On the other hand, centrally planned economies always had some markets. Thus, it might be hard, in practice, to find the boundary between real market socialism and real government-controlled socialism. During its period of communist government, the Hungarian Republic adopted reforms that made it a fair approximation to "market socialism" and the criticisms of market socialism in Hungary suggest a more general obstacle to market socialism.

The technical term is "soft budget constraints". The meaning is simpler than the term. If a government-owned enterprise should overspend its budget and lose money, what would happen? In practice, government would not allow the enterprise to fail, but would instead "prop it up" with subsidies and "bail it out" with more wasteful government capital investments. Thus, government-owned enterprises that

really should be liquidated would never be liquidated, but would continue to exist, eating up government subsidies. Perhaps even worse, enterprises that could shape up and improve their efficiency would have no incentive to do so. As long as you can fall back on government subsidies to make up losses, why go to the trouble to improve efficiency? (After all, one way to increase in labour productivity is to eliminate your job).

But soft budget constraints are not a market socialist exclusive. Despite the abolition of communism in Eastern Europe, "soft budget constraints" are still a problem there, according to many of the pro-market economic reformers. And, indeed, governments have been known to "bail out" enterprises with government investment and to "prop up" losing enterprises with subsidies even in countries which have never been socialist in any sense.

Here in the United States, some losing Savings and Loan Companies were "bailed out" with government investments in the 1980's, and some of the beneficiaries were the relatives of prominent politicians of both major parties. The problem seems to arise unless the control of enterprises is distinctly separated from the control of government. When the government owns the enterprises, or the owners of enterprises control the government, "soft budget constraints" become a problem.

However, it is plausible that a real-world "market socialist" system would be especially vulnerable to the "soft budget constraint" problem, since the enterprise is government owned, the manager a political employee, and a separation between the control of enterprises and the control of government is especially difficult to establish.

9.6 MARKET SOCIALISM: EXPERIENCE OF SCANDINAVIAN COUNTRIES

Scandinavia is in the midst of an economic transformation. Thanks to tax reform, openness to investment/trade, sound property rights, little corruption, and continuing efforts to privatise, economies there have made great strides toward liberalisation. So, Denmark, Finland, Iceland, and Sweden have been rated "free" economies by the Heritage Foundation's 2006 Index of Economic Freedom.

Scandinavian countries have low corporate tax rates and transparent procedures to establish a business. Moreover, these countries have implemented numerous reforms over the past couple years. For instance, cutting income taxes has become one of Iceland's crowning economic achievements. Denmark has been ranked by the Economist Intelligence Unit (EIU) as having the best business environment thanks to, among other things, its flexible labour market.

Despite the good news about reform, other details remain grim. Sweden has extremely high taxes, which encourage workers to cut hours to avoid them. The Norwegian government continues to drag its feet on privatisation, thus thwarting investment into the country. Additionally, the Scandinavian welfare state hinders productivity by enabling otherwise healthy workers to stay at home.

Every day about one-fifth of the workforce stays home in Sweden. These "potential" workers are receiving disability benefits or are on sick leave. The Swedish government's aim is to help bridge the gap between sickness and work. But many take advantage of these benefits and use them as permanent income, as evidenced by the increase in disability and sick leave over the past decade.

Scandinavia also has generous paternity leave. In Iceland, fathers can take up to three months off while receiving 80% of their salary. Swedish couples are entitled to take up to 480 days (240 per person). The first 390 days pay 80% of parents'

ifying income, while the last 90 days pay a flat rate of 60 Swedish krona (at \$8.40) per day. Not surprisingly, 95% of the high-rate benefit days are used.

In Finland “nearly 7 out of ten new retirees rely on some form of unemployment or disability payments”, the OECD reported this year. On the other end of the age spectrum, generous benefits encourage the young to take their time with school, delaying entry into the workforce.

Whether they work or not, it’s unlikely that Scandinavians will have to worry about having a roof over their heads. Several countries have housing programmes. Almost 75% of the Finnish populations, even high income earners, are eligible for government-subsidised housing, according to the OECD. Denmark manipulates the housing market through direct subsidies and price regulation. Sweden offers a housing allowance based on housing costs and the number of children in the household.

Paying for medical coverage is not a concern either. Scandinavia’s generous health-care system is well known, with the government continuing to pick up most of the tab. For instance, the EIU reports, the Norwegian system gives free treatment to all “with the exception of adult dental care and opticians.” The government pays 84% of health-care costs.

Likewise, Iceland’s central government covers about 85% of the costs, with patients contributing toward outpatient care and pharmaceuticals. Iceland has more doctors per 1,000 inhabitants than the United States and United Kingdom do.

Swedes Get Subsidised Health Care; Subsidised health care is available to all Swedish residents. Adults may be charged up to 900 krona (about \$126), whereas children (anyone under 20) receive free care. Dental care, while subsidised from the national dental insurance, has been deregulated, allowing providers to set their own fees. Health care is largely a public-sector effort, with only 8% of physicians in private practice. Private insurers pay for less than 1% of health care.

Denmark’s system gives coverage to everyone, although immigrants must wait six weeks for coverage to start. Health care is free, with the exception of “dental care and physiotherapy.” Medication is subsidised. The majority of health-care costs, 86%, are covered by local municipalities, with the rest of the money coming from the central government (5%), private insurance (5%), and employers (4%), reports the EIU. Finland also has a low number of general practitioners, and until recently Finns had to wait for a long time for care.

Danes are subject to numerous taxes, including state income taxes and municipal, county, and church taxes. Swedish taxes are so high that even the Swedish tax authority doesn’t want to pay them. These commercials, which encouraged Swedes to pay their taxes on time, would have cost “50 to 100% more to make in high-tax Sweden.” Despite having high personal income taxes, Sweden has low corporate taxes with a flat 28% rate. The inheritance and gift tax was abolished in 2004.

Iceland’s low corporate and personal income taxes are an exception to the rule, and they will go even lower thanks to reforms that started in 2004 and that will continue through next year. The general rate for personal income tax will be lowered to 21.75% by 2007. Corporate rates in these countries are considerably lower than income tax rates, indicating that Scandinavian governments recognise the necessity of low rates to attract new investment.

Open for Business: These countries have a solid base for investment through their protection of property rights and strong rule of law. Moreover, they offer an educated workforce, a range of natural resources, and little or no corruption. In

addition to low corporate tax rates, the Scandinavians have made other notable changes to open the door to investment.

Privatisation has come to these countries, thus increasing opportunities for investment, although some have been slower than others. The EIU notes that privatisation has exposed "Denmark to increased competitive pressures" and has provided a "useful source of income for reducing public-sector debt".

Applications to establish a new business in Iceland are usually handled in one day. In business, time is money, thus Iceland's quick turnover results in lower overhead costs. Likewise, Denmark offers "quick, informal and cost-efficient establishment procedures", Investors in Denmark says. Denmark also offers an online registration system and boasts that a company can be incorporated "within a few hours".

Establishing a business in Sweden takes a little longer, about two to three weeks. Yet according to a report by the World Bank, it's worth the wait. A 2005 World Bank comparison of 145 countries found that Sweden is one of the world's top ten economies in "terms of ease of doing business".

Starting a business in Finland is easy. The Finnish government reports that 185 new foreign-owned companies opened their doors there last year. Finland's location aids its success in attracting new companies.

These countries also have a history of trade and are known for exports such as bacon, oil, autos, fish, timber, machinery, and cell phones. Their free-trade policies have contributed to their growth. According to the Heritage Foundation, Denmark, Finland, Norway and Sweden have a "low level of protectionism", while Iceland has a "moderate level".

Denmark, Finland, and Sweden are members of the European Union (EU). Iceland and Norway belong to the European Free Trade Association (EFTA) and to the European Economic Area (EEA). The EEA covers the 25 member states of the EU plus Iceland, Liechtenstein, and Norway.

These countries still have much room for improvement despite the strides that they have made toward liberalisation. Scandinavian countries have a good deal to offer, yet their reluctance to radically reform the welfare system makes them their own worst enemy. According to Stephen Brugger, executive director at the American Chamber of Commerce in Denmark, it is impossible to maintain things the way they are while expecting different results.

These countries could learn a lot from Iceland. It has one of the highest labour-participation rates in the world, with older people staying in the workforce longer. Little Iceland has experienced larger growth and lower unemployment than the other countries. It seems that tax reform, privatisation, and citizens who are willing to work benefit growth.

Scandinavia has taken notable steps toward liberalisation and has benefited greatly from it. If history is any indication, greater liberalisation will bring greater investment. This transformation depends in large part on political will. Various factors, including the competitive forces of globalisation and the fiscal pressure of large aging populations, may convince their leaders that there's still work to be done.

What is distinctive about the Scandinavian countries is their strong social democratic tradition and corporatism that brought about the active welfare state at the center of which stands employment stimulation (for example, by means of extensive child care facilities) and job creation, particularly in the public sector, where, with the exception of Finland, more than 30% of total employment is concentrated. In recent years this welfare system has once more been combined with competitiveness.

Costly high public employment and leave schemes providing temporary jobs for the unemployed also belong to this system. Less positive aspects of the Scandinavian model are the relatively low efficiency of the public sector and the high sickness leave in Sweden, Norway, and – though to a somewhat lesser extent – Finland, which raises the employment rate. And fortunate circumstances such as the quality image of Scandinavian goods, the house price bubble, and Danish – not to mention Norwegian – oil have also pushed up growth and employment.

Reasons for the Success of Scandinavian Countries:

- Scandinavian countries such as Sweden and Finland seem to be cases where history defies what logic (i.e. economics) dictates. In other words, we should expect these countries to crumble under their contradictions as did other countries in the past, such Uruguay or Argentina. There is more free entrepreneurial activity than in the Nordic countries. At least three fundamental issues explain Scandinavian success.
- First of all, Scandinavian countries have a long tradition of rule of law and protection of property rights. Their institutions are very sound, and corruption is very low. For instance, the very dynamic and free economy that existed in Sweden before WWII was based on this institutional background.
- Second, these countries show the importance of Smithian growth. Indeed, as argued above they have been opened to international trade for a long time and have highly benefited from the large markets that come with international trade. The exports sectors are not overburden by government regulations to make sure investment continues and opportunities are captured. The welfare state has been financed by the gains from trade obtained from international commerce. New Zealand, for instance, chose to focus on its relationship with Britain for most of the 20th century. It was left with very little international trade when this relationship fell apart in the early 1970s. In the absence of the international trade with Britain, there was no export industry and thus nothing to finance the welfare system. The economy imploded.
- Third, Scandinavian countries are small and still have very homogenous populations. In these conditions, individuals believe they are contributing to a system which will work for them, for their families or for their fellow citizens who also contribute to the system. In other words, they don't think it will be abused by free-riders. Alesina, Baqir, and Easterly wrote on the issue of redistribution in the context of non-homogenous populations in US cities. When populations are fragmented because of ethnicity, religion or income levels, people are less inclined to finance core public goods and other types of redistribution. The opposite logic likely applies to the small, homogenous Nordic countries.
- With good institutions, a history based on free markets, small homogenous populations, and opened economies; they have been able to finance welfare systems for a while. However, as other European welfare states such as France and Germany are learning, the logic of economics always prevails in the long run.
- When full-time workers in Sweden lose a job, they remain on full pay for a year. During that time, they are eligible for retraining at government's expense. And if they remain unemployed after a year, they may qualify for unemployment compensation, equivalent to an average income, indefinitely.
- Education, including university study, is available to everyone at no cost as are health care and numerous social services. Swedish citizens pay for these benefits through taxes, which by American standards are very high. For

example, personal income tax in Sweden can be as high as 55% and in Denmark can exceed 60%, compared to a maximum rate of about 35% in the United States.

- Economist Jacob Kirkegaard says low corporate taxes – ranging from 18 to 28%, compared to about 40% in the United States – as well as low corruption and violence make Scandinavian countries attractive to foreign and domestic investors. Although Scandinavian labour is highly organised, unions are focused on creating jobs, rather than protecting them. They foster a system popularly called flexicurity, which includes generous unemployment benefits, but also an obligation on the part of workers to accept government sponsored training for new jobs.

But many economists point to flaws in the Scandinavian economic model. Marian Tupy, a policy analyst at the Cato Institute in Washington, says expensive social welfare systems sooner or later run out of money. He notes that in the past 15 years, northern European countries have had an average economic growth rate of just 1.5% per year, compared to three per cent in the United States.

Still, the combination of social welfare and the ability of Scandinavian countries to integrate into the global economy have attracted the attention of a number of countries seeking to improve their socio-economic model. South Korea is one of them.

Most economists agree that the Scandinavian economic model is very hard to emulate, especially in poor nations that cannot afford to impose the high taxes needed to support an expensive welfare state. This model may work in small, rich countries with homogeneous and well-educated populations and a long history of income sharing. But some analysts argue not forever.

Among social scientists the term Scandinavian has a clearly different meaning than among physical geographers. For them the term usually refers to a particular welfare regime, and a public sector strongly empowered to intervene in the lives of individuals and families with the help of elaborate systems of social policy.

9.7 MARKET SOCIALISM: EXPERIENCES OF NORDIC COUNTRIES

The Nordic countries form a particular and institutionally very integrated market area of which relatively little is known even in Europe – not to mention the other continents. The region consists of five countries, Denmark, Finland, Iceland, Norway and Sweden, as well as three self-governing regions, the Faroe Islands and Greenland (Denmark) and the Åland Islands (Finland). The small and open Nordic economies are highly dependent on foreign trade. This means that for them globalisation and its future forms are obviously of a particularly vital interest. Of the Nordic Countries Denmark, Norway and Sweden form a geographical entity often known as Scandinavia. Finland, instead, is not a Scandinavian country in a strict geographical sense.

The Nordic economies, though there were differences among the five countries, were characterised by high levels of public expenditure — both social expenditure as well as public consumption. Social expenditure in the Nordic countries pertained to the funding of public welfare services such as education, healthcare, child care, and other social services and large-scale income transfers such as subsidies, unemployment benefits, maternity (or paternity) benefits, old age and disability pensions, student benefits, and housing benefits.

The Nordic countries have consistently figured among the top fifteen countries ranked on global competitiveness, in the report prepared by the World Economic Forum. The Nordic economic model, characterised by market-based economies and generous welfare systems, seemed to be working well, with the countries in the region figuring at the top of various lists that ranked countries on the basis of human development, per capita wealth, economic freedom, etc.

It is often claimed that in the postwar period, one can discern a Nordic Model of socio-economic development. The model was based on a capitalist economic system, but incarnates political concerns for social equality. It is a specific version of the mixed economy: an economy managed by political forces with a strong commitment to the welfare of the broad masses, favoring goals such as full employment, an egalitarian income distribution, and general social citizenship through universal pension schemes and provision of social services.

The model was marked by strong domestic consensus, high levels of organisation (of labour, capital and agriculture), and low levels of social conflict: a Nordic version of organised capitalism. Towards the end of the period, there was also greater equality between the sexes, and high employment rates for women.

According to a standard typology, there is a peculiar Nordic type of social democratic welfare state. It entails a specific institutional model of social policies, in which the provision of a secure standard of living is guaranteed as far as possible independently of market mechanisms. Supplementary pensions, however, are indexed to wages. Health and educational services are provided for all at a low cost. The basic pension system was established in the late 1940s/1950s and extended in the late 1960s, as benefits were generalised and indexed to the rise in living standards. There was also a major expansion of health and education systems. Welfare mechanisms exist in terms of both legislation and organisational structures.

Social democracy in the Nordic countries is strong evidence for the achievements of unions as opposed to workers' ownership. The success of unions may seem obvious today, but to many early leaders of the labor movement in the nineteenth century, worker cooperatives were as relevant a goal as extensive union membership – and just as distant. But while unions grew to become important actors in the labor markets of northern Europe and elsewhere, worker cooperatives remained on the margins.

Comprehensive union movement is indeed an important characteristic of the Nordic model of social democracy. Yet one should not underestimate the importance of strong employer associations to the system. Together the two parts of the labour market tend to take wages out of competition by way of centralised wage negotiations. The role of employers is often forgotten by the critics of the system. If the employers so desired, they could easily dissolve the system by withdrawing from central wage negotiations.

In addition, the Nordic model is distinguished by a large welfare state and a system of routine consultation among government and representatives of interest organisations. Its policies include wage leveling through solidaristic bargaining, the provision of basic goods for all citizens as a right of citizenship, and a government commitment to full employment.

The lessons for mainstream economics may be particularly harsh. The Nordic countries of Denmark, Finland, Norway, and Sweden seem to violate what the economics profession has long viewed as necessary requirements for an economy to prosper. Their wage differentials are too small, their taxes are too high, their public sectors are too large, their welfare states are too generous, and their unions are too strong. Despite these violations, the Nordic countries have for decades done extremely well. What most economists see as a recipe for serious economic

trouble seems, in the Nordic countries, to be consistent with high growth, low unemployment, low inequality, and a fairly efficient allocation of resources.

The Nordic model is also characterised by high female labor force participation. Again, there are mutual dependences between the labour market and the welfare state. As women joined their husbands in the labour force, households naturally demanded more public care for children and the elderly. The gradual expansion of the welfare state made it easier for even more women to enter the workforce, which in turn led to higher support for welfare spending and to stronger economic growth.

The Nordic Countries form a distinctive group of small, open, market economies with their traditionally particular forms of interplay between regulatory bodies and business sector.

The Nordic Countries are typically societies with small and ageing but highly educated populations. They are also societies whose economies are remarkably open vis-à-vis the global markets. These features are highly significant for the overall structuring of the Nordic societies; to some extent they can even be taken as their “determining” features.

Among social scientists the term Scandinavian has a clearly different meaning than among physical geographers. For them the term usually refers to a particular welfare regime, and a public sector strongly empowered to intervene in the lives of individuals and families with the help of elaborate systems of social policy. If the question concerns universal welfare, provided to all members of the society, all the Nordic Countries can be regarded as being “Scandinavian”. Innovations in transnational institutional systems of social policy are without any doubt among the key aspects of the integrated Nordic market area.

Agreements that established common Nordic social security and labour market areas in the mid-1950s opened the borders, labour markets and social welfare systems in each of the Nordic countries to other Nordic citizens. Thus, for almost the past fifty years each of the Nordic countries has been obliged to treat all Nordic citizens equally, irrespective of their nationality, as clients of social security or labour market authorities. The impact of such arrangements on intra-Nordic labour force mobility, traditionally from Finland to Sweden, has been remarkable.

Although it has been subjected occasionally to certain, often politically coloured, criticism, the Human Development Index (HDI), given as a standardised value between 0 and 1, can be said to provide a feasible way of comparing societies. It combines an indicator of national economic performance – typically GDP/capita – with equally simple indicators reflecting the state of their human resources.

Altogether 174 countries were ranked in the Human Development Report by the HDI. All Nordic countries were included in the group of the best fifteen performers, and hence in the upper half of the most advanced countries in terms of human development. Norway held the top Nordic position, accorded number two spot in the global ranking. Denmark was number fifteen in the global positioning, and the rest of the Nordics were scattered between these two countries.

A common feature of Nordic populations is their relatively small size. Moreover, in four of the five countries (Norway is the exception), the population growth rates are expected to diminish as we move towards the year 2015.

Iceland differs from the rest of the Nordic group with an expected population growth rate remaining high despite of a noticeable drop. Intimately connected with diminishing growth rates is the ageing of the population and hence dependency ratios growing more and more disadvantageous in all Nordic countries with the exception of Iceland.

If the Nordic countries are to remain highly competitive in the field of human development, as reflected in overall economic performance, their sources of competitive advantage derived from the physical environment and locational factors may remain modest. The biologically measurable environmental quality may not be particularly problematic in circumstances in which the anthropogenic environmental stress per unit of area remains low due to an overall abundance of territory in relation to the population that inhabits it.

Instead, the Northern climate and the associations attached to it may become more problematic issues in an era of human-capital-centered economy with an intensive growth of sun-belt regions. This is a phenomenon already visible both in the US and in Europe. The sparsely populated Nordic latitudes in their chilly November darkness may not attract the global key talents unless (and even this may be questioned) they are born Northerners.

The single most striking feature of the Nordic corporations on the list of global giants is how surprisingly evenly they are distributed on the list. Even if the Nordic economies are small as original home markets, there are corporations with a Nordic core even among the world's largest business entities.

Despite their good performance in procuring the key resources needed to thrive in the competitive, human-centered new economy, the Nordic countries have plenty of future challenges to meet. For those with ambitions to put the Nordics to compete with the globally mid-sized EU economies, intending to conquer them with mass-market products of the new economy, just as Ericsson and particularly Nokia have done in the field of dispersed technology needed for bringing about the new economy, the future may be filled with nasty surprises. As was noted above, a plethora of factors seem to contradict the idea that the Nordics should be particularly successful in the field that could be most suitable to them, given their superb human resources: the global top-class, state-of-the-art, high-tech vanguards of the new global economy.

It may well be assumed that the Nordics will remain globally rather extreme, or possibly even eccentric, cases. Thus they probably attract rather extreme/eccentric individuals – as far as the mobility of professionals is concerned – to enter their stocks of human capital. Consequently, it may be assumed that their global success, with high value-adding industries, will lie in their ability to find niches that may be easiest to identify by the extreme individuals working in extreme circumstances. Every now and then the right niche, such as the mobile communications, is found, and that niche may even widen to become a mass market. However, in such case simultaneously the industry explodes globally, leaving behind the limits set by the inadequate domestic demand, small domestic labour markets, lacking domestic venture and financial capital, and so on.

The globally most competitive Nordic economies and their key corporations that saw the light of the day already in the 19th century have played a major role in bringing a great deal of the world to the verge of the new economy. The Nordic societies appear to have had the right combination of structural and human factors to facilitate this achievement.

Nordic countries have in recent years attracted attention due to their dynamic adaptability to the globalised economy. From the perspective of the literature on 'Variety of Capitalism' this type of adaptability can be characterised as a surprising outcome. Institutional complementarities and strong inter-linkages between various stakeholders are seen to cause inertia, and have less capacity for the reshuffling of resources necessary for radical innovation. Instead non-market forms of coordination are seen to support only incremental innovation. Thus the current dynamic in the Nordic countries challenges the inertia thesis related to non-market coordination mechanisms.

Nordic countries have reshaped their national business systems by transforming their coordinated system of governance. Instead of centralized modes of coordination, governance has been decentralized to various sub-systemic levels of action. In this way the Nordic countries have reproduced distinguishing governance mechanisms to the extent that it makes sense to still characterize them as coordinated market economies.

Check Your Progress 2

- 1) What are the problems of market socialism?

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9.8 LET US SUM UP

In this unit we have discussed about market socialism, their meaning and their theoretical basis. Followed by discussion are also made on the market socialism of Scandinavian and Nordic countries. Problems of market socialism and the working of market socialism in Scandinavian and Nordic countries are also discussed.

9.9 KEY WORDS

Market socialism : Market socialism is a term used to denote two different economic systems based in socialism which operate according to market principles.

9.10 SOME USEFUL BOOKS

- 1) Gary M Pickersgill and Joyce E Pickersgill (1974): "*Contemporary Economic Systems a Comparative View*", Prentice - Hall, Inc., Englewood Cliffs, New Jersey.
- 2) Peter Koslowski (1998): "*The Social Market Economy*", Springer Verlag Germany.
- 3) Michael Parkin, Melanie Powell and Kent Mathews (1997): "*Economics*", Addison Wesley Longman Limited.
- 4) Schumpeter J A (1954): "*History of Economic Analysis*", Oxford University Press, New York.

9.11 ANSWER OR HINTS TO CHECK YOUR PROGRESS

Check Your Progress 1

- 1) Market socialism is a term used to denote two different economic systems based in socialism which operate according to market principles. The first term relates to an economy directed and guided by socialist planners on either a local or state level, while the second refers to a system of free exchange with socialist organisations being predominant.

- 2) Lange and Fred M. Taylor proposed that central planning boards set prices through “trial and error”, making adjustments as shortages and surpluses occurred rather than relying on a free price mechanism. If there were shortages, prices would be raised; if there were surpluses, prices would be lowered. Raising the prices would encourage businesses to increase production, driven by their desire to increase their profits, and in doing so eliminate the shortage. Lowering the prices would encourage businesses to curtail production in order to prevent losses, which would eliminate the surplus. Therefore, it would be a simulation of the market mechanism, which Lange thought would be capable of effectively managing supply and demand.

Check Your Progress 2

- 1) Government-owned enterprise maximising profits at market prices would run into some of the same problems that market capitalism would. Monopoly and externality could also be problems.

9.12 EXERCISES

- 1) What is market Socialism? Explain the Lange’s model of market socialism.
- 2) Explain the problems of Market Socialism.
- 3) Explain the economic development experience of Scandinavian countries.
- 4) Explain the economic development experience of Nordic countries.

NOTES

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